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Internal Revenue Service (I.R.S.)
Senate Report

REVENUE BILL OF 1934.

March 28, 1934

[Senate Report No. 558, Seventy-third Congress, Second Session. Calendar No. 591.]

[March 28, 1934.]

Mr. Harrison, from the Committee on Finance, submitted the following report [to accompany H. R. 7835]:

The Committee on Finance, to whom was referred the bill (H. R. 7835) to provide revenue, equalize taxation, and for other purposes, having had the same under consideration, report favorably thereon, with certain amendments, and as amended recommend that the bill do pass.

ADDITIONAL REVENUE.

The House bill provides for additional revenue estimated at $258,000,000 in a full year of operation. This additional revenue is to be derived to a large extent from measures adopted to prevent tax avoidance. Your committee is in complete agreement with the policy of preventing such avoidance. However, some of the changes proposed to existing law by the House bill, in the opinion of your committee, would have an unfavorable effect on business and would prevent only an inconsequential amount of tax avoidance. Some modifications in the House bill, therefore, are recommended. Your committee recommends increasing the revenue provided for in the House bill by imposing the capital-stock and excess-profits taxes patterned after those levied by the National Industrial Recovery Act. It also recommends an increase in the estate-tax rates in the case of net estates of over $1,000,000. These measures are believed necessary, first, because of the heavy emergency expenditures of the Government, and, second, because of the fact that many excise taxes under existing law will be automatically repealed on July 1, 1935. The capital-stock and excess-profits taxes, if imposed on a permanent basis, will add stability to our tax system and will produce sufficient additional revenue to give assurance of a balanced Budget by 1936. It is estimated that in a full year of operation the Senate bill will return additional revenue of $330,000,000, or approximately $72,000,000 more than the House bill.

The estimated additional revenue mentioned is shown in detail as follows:

(1) Capital-stock and excess-profits taxes..	$95,000,000
(2) Increases in estate tax rates...	7,000,000
(3) Changes in income-tax rate structure..	20,000,000
(4) Administration of depreciation allowances...	85,000,000
(5) Capital gains and losses..	30,000,000

(6)	Personal holding companies (directly or indirectly)...............................	20,000,000
(7)	Exchanges and reorganizations..	10,000,000
(8)	Consolidated returns..	20,000,000
(9)	Partnerships..	5,000,000
(10)	Administrative changes (gasoline and lubricating oil)............................	18,000,000
(11)	Miscellaneous provisions..	20,000,000
	Total...	330,000,000

It should be observed that both the $258,000,000 of additional revenue estimated from the House bill and the $330,000,000 additional estimated from the bill as now reported are for a full year of operation. As far as the fiscal year 1935 is concerned, about $175,000,000 of additional revenue may be expected from the House bill or from the bill as reported. This difference results chiefly from the fact that the income-tax changes do not become effective from a revenue standpoint until returns for 1934 are filed in 1935. On account of the installment method of payment permitted, it will probably result that only about 60 per cent of the additional revenue for a full year will be actually received in the fiscal year 1935. Moreover, the capital-stock tax and excess-profits taxes, proposed in the bill as reported, will produce only $15,000,000 additional in the fiscal year 1935 against $95,000,000 in 1936. This is because $80,000,000 is already included in the Budget estimates for 1935 from the last capital-stock tax returns required to be filed under the National Industrial Recovery Act.

STATE OF THE FINANCES.

It is apparent from the message of the President transmitting the Budget, from the Budget statements, and from the annual report of the Secretary of the Treasury that the Government is vitally in need of the additional revenue sought to be provided by this bill.

The deficit for the fiscal year 1933 was approximately $2,602,000,000 and the estimated deficits (exclusive of debt retirement) for the fiscal years 1934 and 1935 are approximately $7,309,000,000 and $1,986,000,000, respectively. The following tables taken from the House report on the bill show the financial situation as it existed at the beginning of the present calendar year prior to the enactment of the Liquor Taxing Act of 1934 and without respect to the revenue to be derived therefrom or from this bill:

TABLE I.--*Summary of receipts and expenditures for the fiscal year 1933, on the basis of daily Treasury statements (unrevised), and estimated receipts and expenditures for the fiscal years 1934 and 1935.*

	1933, actual.	**1934, estimated.**	**1935, estimated.**
Receipts:			
Internal revenue..........................	$1,604,423,956.56	$2,663,600,000	$3,333,100,000
Customs......................................	250,750,251.27	399,000,000	466,000,000
Miscellaneous.............................	224,522,533.93	197,338,756	175,565,479
Total receipts..............................	2,079,696,741.76	3,259,938,756	3,974,565,479

Expenditures (exclusive of debt retirement):			
General..	3,404,310,658.88	2,530,720,267	2,486,768,200
Agricultural Adjustment Administration..		514,800,000	750,744,000
Emergency..	1,277,038,167.73	6,357,486,700	723,280,500
Total (as per Budget)............................	4,681,348,826.61	9,403,006,967	3,960,798,700
Additional expenditures as recommended by the President....................		1,166,000,000	2,000,000,000
Total expenditures................................	4,681,348,826.61	10,569,006,967	5,960,798,700
Excess of expenditures over receipts (exclusive of debt retirement)...............	2,601,652,084.85	7,309,068,211	1,986,133,221

TABLE II.--*Detail of receipts for the fiscal year 1938, on the basis of daily Treasury statements (unrevised), and estimated receipts for the fiscal years 1934 and 1935.*

Receipts.	1933, actual.	1934, estimated.	1935, estimated.
GENERAL AND SPECIAL FUNDS COMBINED.			
Internal revenue: Income taxes.........	$746,206,444.95	$864,000,000	$1,265,000,000
Miscellaneous internal revenue--			
Estate tax..	29,693,061.89	86,000,000	117,000,000
Gift tax...	4,616,661.96	2,000,000	2,000,000
Spirits and fermented liquors...........	43,174,316.92	243,900,000	819,800,000
Tobacco manufactures.....................	402,739,659.25	423,000,000	445,000,000
Dues of clubs (athletic, social, and sporting)...	6,679,260.95	6,000,000	7,000,000
Admission to theaters, concerts, cabarets, etc......................................	14,520,512.30	15,500,000	17,200,000
Stamp taxes, including playing cards	57,338,202.47	72,400,000	92,800,000
Oleomargarine, process butter, etc....	1,362,702.42	1,500,000	1,500,000
Miscellaneous, including prohibition and narcotic collections, delinquent taxes under repealed law, etc............	1,283,638.90	1,000,000	1,000,000

Lubricating oils................................	15,232,924.81	22,900,000	25,900,000
Brewer's wert, malt, grape concentrates, etc................................	5,707,904.63	5,400,000	5,200,000
Matches...	2,871,992.13	7,000,000	7,000,000
Gasoline [1]	120,099,103.44	145,000,000	151,000,000
Electrical energy..............................	26,562,739.33	32,900,000	33,500,000
Tires and inner tubes.......................	13,980,084.52	25,500,000	26,700,000
Tollet preparations, etc....................	9,102,539.37	13,800,000	16,800,000
Articles made of fur.........................	7,546,274.34	11,500,000	14,500,000
Jewelry (watches, clocks, opera and field glasses, etc.).............................	3,068,494.24	4,800,000	5,600,000
Automobile trucks............................	1,654,010.02	3,200,000	3,800,000
Other automobiles and motorcycles..	11,573,922.08	24,300,000	34,400,000
Parts or accessories for automobiles.	3,097,276.24	4,200,000	5,300,000
Radio sets, phonograph records, etc..	2,206,763.39	2,800,000	3,400,000
Mechanical refrigerators..................	2,111,868.76	4,600,000	5,700,000
Sporting goods, cameras, and leases.	2,871,682.37	3,700,000	4,300,000
Firearms, shells, and cartridges.........	932,221.91	2,500,000	3,100,000
Candy and chewing gum.................	3,650,227.65	4,600,000	6,100,000
Soft drinks..	3,686,447.33	4,900,000	6,100,000
Telephone, telegraph, radio, and cable facilities, leased wires, etc.......	13,564,756.17	17,200,000	21,600,000
Transportation of oil by pipe line......	7,467,297.50	10,000,000	10,000,000
Leases of safe-deposit boxes............	2,865,040.83	2,800,000	2,800,000
Checks, drafts, or orders for the payment of money...........................	37,456,493.49	38,000,000	44,000,000
National Industrial Recovery Act taxes [2]		153,700,000	80,000,000
Total, miscellaneous internal revenue...	858,217,511.61	1,396,600,000	1,520,100,000
Processing tax on farm products (special fund)..............................		403,000,000	548,000,000

Total, internal revenue......................	1,604,423,956.56	2,663,600,000	3,333,100,000
Customs (excluding tonnage tax):			
Distilled spirits and fermented liquors..		89,000,000	84,000,000
All other [3]	250,750,251.27	310,000,000	382,000,000
Total, customs..	250,750,251.27	399,000,000	466,000,000
Miscellaneous receipts:			
Proceeds of Government-owned securities:			
From foreign obligations........................	98,757,726.20	20,000,000	[4]
From all other obligations.......................	32,090,746.50	95,439,315	79,952,416
Panama Canal tolls, etc...........................	23,267,500.34	25,672,424	25,661,000
Other miscellaneous...............................	70,406,560.89	56,227,017	69,952,063
Total, miscellaneous..............................	224,522,533.93	197,338,756	175,565,479
Grand total, receipts...............................	2,079,096,741.76	3,259,938,756	3,974,665,479

The deficits shown in Table I, above, do not include the statutory debt retirements, chiefly for the sinking fund, amounting to $461,604,800 in the fiscal year 1933 and to estimated sums of $488,171,500 and $525,763,800 in the fiscal years 1934 and 1935. On the other hand, since the deficits shown were estimated without regard to the revenue expected from the Liquor Taxing Act of 1934 and from this bill, it is hoped that the deficit for 1934 will be considerably reduced and for 1935 very substantially reduced.

In spite of the size of the deficits, we should find encouragement in the following facts:

First, the general, or ordinary, operating expenditures of the Government have been substantially reduced, as shown by Table I.

Second, the revenues have been constantly increasing during this fiscal year as compared with those of the prior fiscal year. From July 1, 1932, to March 22, 1933, total receipts amounted to $1,478,266,569, while from July 1, 1933, to March 22, 1934, total receipts amounted to $2,262,517,269. This represents an increase in revenues in the current fiscal year of 53 per cent over the revenues for a corresponding period in the prior fiscal year. The revenues for the first 22 days of March of this year exceed the revenues for the first 22 days of March, 1933, by 65 per cent.

Third. The income tax, the barometer of business profits, shows an increased yield of 40 per cent in the first 22 days of March of this year over the corresponding 22 days of March of last year. This means that calendar year 1933 profits were substantially more than calendar year 1932 profits, since there were no increases in rates of tax.

Fourth. The tobacco tax, the barometer of the expenditures and the employment of the public, shows an increased yield for the fiscal year 1934 up to March 1 of 8 per cent over the corresponding period in the fiscal year 1933. February, 1934, receipts from this tax were 17 per cent above February, 1933, receipts. There were no changes in the tobacco tax rates during these periods.

Thus, we may look forward with assurance to the time when receipts will exceed expenditures, when the orderly retirement of the public debt may be resumed, and when the burden of taxation may be reasonably lightened. The first of these objectives should certainly be reached not later than the fiscal year 1936, and the enactment of this bill into law will be of substantial aid in bringing about the results desired.

DESCRIPTION OF MAJOR CHANGES PROPOSED.

While all the changes proposed in our taxing system by the bill will be described in detail in the latter part of this report, a general description of the major changes will first be given.

(1) CAPITAL-STOCK AND EXCESS-PROFITS TAX.

The capital-stock and excess-profits taxes are not included in the House bill, but, as previously stated, your committee believes it highly desirable to impose these taxes in view of the state of the finances. Similar taxes were imposed by the National Industrial Recovery Act but were for a temporary period only, depending upon the repeal of the eighteenth amendment. The last capital-stock tax return required under that Act is for the year ending June 30, 1934, and the last excess-profits tax required from any taxpayer is for his taxable year ending prior to December 31, 1934. It results from the terms of the Recovery Act and the repealing section thereof that all taxpayers file two capital-stock tax returns and that the great majority of taxpayers file one excess-profits tax return. A few taxpayers, however, with fiscal years ending on July 31, August 31, September 30, October 30, and November 30 would be obliged to file two returns. This situation has been the only serious criticism brought to the attention of your committee. In all other respects, the taxes have been very satisfactory in their operation up to date. The revenue derived up to February 28 of this year amounted to $80,015,615 in comparison with $80,000,000 originally estimated for the entire fiscal year 1934. Thus the taxes have been certain in yield. They have also been easily borne by the taxpayer and easily administered by the Bureau of Internal Revenue.

Your committee recommends that the capital-stock tax imposed by this bill shall apply to the year ending June 30, 1934, and subsequent years, and that the excess-profits tax imposed by this bill shall apply to the income-tax taxable years ending after such date. In order to prevent duplication in respect to the taxes still imposed by the National Industrial Recovery Act, section 703 of the pending bill repeals the capital-stock tax imposed by that Act for the year ending June 30, 1934, and the excess-profits tax imposed by that Act in respect of taxable years ending after June 30, 1934. This policy will prevent the situation already mentioned, where some taxpayers are required to file only one excess-profits tax return and others are required to file two. Any serious charge of unfairness against the reimposition of these taxes is met by allowing for the year ending June 30, 1934, a new opportunity to declare the fair value of each corporation's capital stock.

(*a*) *Capital-stock tax* (*section 701*).--The provisions of the bill imposing this tax are very similar to the provisions contained in the National Industrial Recovery Act in respect to the tax imposed on the fair value of the capital stock of corporations by that Act. Some changes have been made in order to bring about certainty in the adjustments to be made in the original declared value in arriving at the basis for subsequent years.

In order to avoid controversy as to the value of the capital stock, the tax is imposed for the first year on the value declared by the corporation as of the close of the last income-tax taxable year ending on or before June 30, 1934. A value for the capital stock once having been declared, such value may not be amended. A reasonable original declared value is assured by means of the excess-profits tax, which is based on the relation of the net income of the corporation to such declared value. The rate of the capital-stock tax is very low--$1 per $1,000 of the declared value.

The basis for the capital-stock tax for subsequent years is arrived at by making certain adjustments to the original declared value. The adjustments provided for in the National Industrial Recovery Act were expressed in rather general terms. In this bill these adjustments have been described in more specific terms. The adjusted declared value of the capital stock of a corporation for subsequent years is defined as the original declared value plus (1) the cash and fair market value of property paid in for stock or shares, (2) paid-in surplus and contributions to capital, (3) its net income, and (4) the amount of the dividend deduction allowable for income-tax purposes, and minus (A) the value of property distributed in liquidation to shareholders, (B) distributions of earnings or profits, and (C) the excess of the deductions allowable for income-tax purposes over its gross income. These adjustments are to be made for each income-tax taxable year from the date as of which the original declared value was declared to the close of the taxpayer's last income-tax taxable year ending at or prior to the close of the year for which the capital stock tax is imposed. It is believed that these adjustments are much more certain than the adjustments provided for in the National Industrial Recovery Act.

It should be pointed out that partially tax-exempt interest from obligations of the United States and of certain corporate instrumentalities of the United States will be included in the amounts to be added by way of adjustment to the original declared value, and that such interest will be subject to the excess-profits tax imposed by this bill. The reverse was true under the regulations promulgated in respect to the National Industrial Recovery Act.

It is estimated that the Government will receive additional revenue of $95,000,000 from this tax coupled with the excess-profits tax in the fiscal year 1936. In the fiscal year 1935, $80,000,000 had been estimated from this source, since the Recovery Act provided for the last return as of June 30, 1934, and the collections would not be made until after the close of the fiscal year. The policy recommended by your committee should bring in about $15,000,000 additional in the fiscal year 1935.

(*b*) *Excess-profits tax* (*section 702*).--The bill reported by your committee, as already stated, provides for an excess-profits tax on every corporation for each income-tax taxable year ending after the close of the first year in respect of which it is taxable under the capital stock tax imposed by this bill. The primary purpose of this tax is to induce corporations automatically to declare a fair value for their corporate stock under section 701. The rate is 5 per cent on the portion of the net income in excess of 12½ per cent of the adjusted declared value of the stock of the corporation. The secondary object of the tax is to subject to a somewhat higher rate of tax abnormal profits which are out of proportion to the capital of the corporation.

The rulings of the Treasury Department permitted the filing of the consolidated return for the purpose of the excess-profits tax imposed by the National Industrial Recovery Act. The bill as reported does not permit this privilege. Inasmuch as the capital stock tax is on a separate return basis, it is impossible to make proper adjustments in the capital stock tax values without computing the net income of each corporation separately. The officials of the Bureau of Internal Revenue foresaw great difficulty in making proper adjustments under the Recovery Act in the case of the second capital stock tax return. This difficulty is obviated by the repeal of that tax, and its replacement by the tax carried in this bill for the year ending June 30, 1934.

(2) ESTATE TAX RATES.

Your committee recommends increases in the rates of the “additional estate tax,” imposed by the Revenue Act of 1932 in the case of net estates of $1,000,000 and over. The revised rates are carried in section 405 of the bill.

The rates recommended in comparison with present rates are as follows:

Amount of net estate.	Present rate.	Proposed rate.	Amount of net estate.	Present rate.	Proposed rate.
$1,000,000 to $1,500,000.............	19	20	$4,500,000 to $5,000,000.............	33	37
$1,500,000 to $2,000,000.............	21	22	$5,000,000 to $6,000,000.............	35	40
$2,000,000 to $2,500,000.............	23	25	$6,000,000 to $7,000,000.............	37	42
$2,500,000 to $3,000,000.............	25	27	$7,000,000 to $8,000,000.............	39	44
$3,000,000 to $3,500,000.............	27	30	$8,000,000 to $9,000,000.............	41	46
$3,500,000 to $4,000,000.............	29	32	$9,000,000 to $10,000,000...........	43	48
$4,000,000 to $4,500,000.............	31	35	Over $10,000,000.........................	45	50

It can be seen from this schedule that the rate on amounts of net estates in excess of $1,000,000 and not in excess of $1,500,000 has been increased 1 per cent. This increase has been consistently carried out in the higher estate-tax brackets until in the cases of estates of over $10,000,000 the rate has been increased 5 per cent, or from 45 to 50 per cent.

In the opinion of your committee, these increases will raise about $7,000,000 of additional revenue in a full year of operation, and, moreover, will tend to prevent undue accumulation of wealth. This objective is more properly reached by estate-tax than by income-tax increases. Moreover, the drastic increases made in the income-tax rates by the Revenue Act of 1932 have been most disappointing from a revenue standpoint, and it appears that further income-tax rate increases would have an unfavorable effect upon business recovery. The new rates will affect decedents dying after the date of enactment of this bill.

(3) INCOME-TAX RATE STRUCTURE.

Your committee agrees with the House bill in respect to all the changes proposed in the income-tax rate structure with the sole exception of the amount which is set as a limit for the recognition of earned net income. Your committee believes that the limit set by the House of $8,000 is entirely inadequate to differentiate properly between earned and unearned income, and therefore recommends increasing this limit to $20,000. The changes proposed in the rate structure may be described as follows:

(*a*) *Normal tax.*--Section 11 of the Revenue Act of 1932 provides for a normal tax equal to 4 per cent of the first $4,000 of the net income in excess of the credits provided in section 25, plus 8 per cent of the balance over $4,000.

Your committee recommends the use of one normal rate of 4 per cent and the adjustment of the surtax rates so that the tax burden on incomes other than dividends and partially tax-exempt interest will remain practically unchanged. The principal advantages of this change are (1) simplification; (2) increased tax on dividends; and (3) increased tax on partially tax-exempt interest.

Our first Revenue Acts provided for one normal rate and graduated surtax rates. There appears to be no good reason for having both a graduated normal tax and a graduated surtax, since the principle of ability to pay can be adequately taken care of by the graduated surtax alone. Certainly, it is much simpler to have one normal rate of tax. Through adjustment of surtax rates, this change can be made without appreciably decreasing the revenue.

It is believed that dividends may be properly subjected to a somewhat greater income tax. Under the Revenue Act of 1932 a single man with a net income from dividends of $50,000 pays a tax of $4,960, while a single man with a net income from salary of $50,000 pays a tax of $8,720. In such a case the man with dividend income, under the recommendation of your committee, will pay a tax of $7,170. In other words, instead of paying $3,760 less tax than the salaried man, he will pay only $1,880 less tax. This is due to the fact that dividends are now subject to an 8 per cent exemption from income tax, while under the proposal they will only be subject to a 4 per cent exemption. It is the opinion of your committee that this increased tax on dividends can well be borne. In the case of partially tax-exempt income a similar result is obtained from the single 4 per cent normal rate, since this income is also exempt only from normal tax.

(*b*) *Surtax.*--Section 12 of the Revenue Act of 1932 provides for surtax rates starting at 1 per cent on net incomes of more than $6,000 and reaching 55 per cent on net incomes of more than $1,000,000. Fifty-three different rate brackets are provided for in this Act.

In view of the change recommended in the normal rates, your committee recommends changes in these surtax rates to maintain approximately the same tax on ordinary income as at present, and your committee deems it wise to recommend further the reduction in the number of surtax brackets from 53 to 28 for the purpose of simplification, since the larger number of brackets has been found to be unnecessary.

(*c*) *Personal exemption and credits for dependents.*--Under section 25 of the Revenue Act of 1932, there are allowed as credits against net income for normal tax (but not for surtax) purposes, dividends, interest on obligations of the United States, personal exemption, and credits for dependents.

To carry out the policy of retaining practically the same tax burden on ordinary income, it is necessary in connection with the proposed plan to allow the personal exemption and credits for dependents as an offset against surtax as well as normal tax. The personal exemption and credits for dependents would appear to be in lieu of deductions for necessary living expenses. They may well apply to both taxes as do all other ordinary deductions.

(*d*) *Earned income credit.*--The Revenue Acts of 1924, 1926, and 1928 all contained a 25 per cent tax credit for earned income. The revenue bill of 1932 as passed by the House, while retaining the principle that moderate earned incomes should bear a somewhat lower tax than investment incomes of equal size, changed the form of the relief from a credit against the tax to a credit against net income. The Senate under the demands for more revenue struck out earned income relief entirely.

Your committee is of the opinion that a small relief on earned incomes is justified at this time in order that the tax on various classes of income may be proportionate to the ability to pay of the taxpayer having such income. The form of relief proposed in the revenue bill of 1932 as passed by the House is preferred on account of its much greater simplicity. Accordingly, it is proposed to allow a credit against net income subject to normal tax equal to 10 per cent of the amount of the taxpayer's earned income. The credit is very substantially limited, however, by providing that earned income in excess of $20,000 shall not be recognized as earned, and by providing that the earned income credit shall not exceed 10 per cent of the taxpayer's net income. On the other hand, amounts of net income up to $3,000 are recognized as earned, whether earned or not, for administrative reasons. The greatest tax reduction possible to any one taxpayer under this provision amounts to $80. Under the House bill with a $8,000 limit, the greatest reduction possible amounted to $32.

(*e*) *Effect of rate structure changes.*--The changes recommended in paragraphs (*a*), (*b*), (*c*), and (*d*), above, are interrelated, and it is now necessary to point out the combined result of these changes. The exact results are shown in two tables, which set forth the present and proposed taxes on various amounts and kinds of net income in the case of both single and married persons.

Comparison of present and proposed taw.

SINGLE MAN.

Net income.	If all earned income.[1]		If half earned income and half dividends.[2]		All dividends.[2]	
	Present law.	Proposed.	Present law.	Proposed.	Present law.	Proposed.
$2,000...........................	$40	$32	$0	$0	$0	$0
$3,000...........................	80	68	20	8	0	0
$3,500...........................	100	86	30	18	0	0
$4,000...........................	120	104	40	28	0	0
$4,500...........................	140	122	50	38	0	0
$5,000...........................	160	140	60	48	0	0
$6,000...........................	240	216	80	108	0	40
$7,000...........................	830	292	110	166	10	80
$8,000...........................	420	368	140	224	20	120
$9,000...........................	510	444	170	282	30	160
$10,000.........................	600	530	200	350	40	210
$12,000.........................	800	712	320	496	80	320
$14,000.........................	1,020	914	460	662	140	450
$16,000.........................	1,260	1,136	620	848	220	600
$18,000.........................	1,520	1,388	800	1,064	320	780
$20,000.........................	1,800	1,680	1,000	1,320	440	1,000
$25,000.........................	2,640	2,600	1,640	2,130	880	1,720
$30,000.........................	3,600	3,660	2,400	3,080	1,440	2,580
$40,000.........................	5,920	6,100	4,320	5,300	2,960	4,620
$50,000.........................	8,720	9,050	6,720	8,050	4,960	7,170
$60,000.........................	12,020	12,510	9,620	11,310	7,460	10,230
$70,000.........................	15,820	16,450	13,020	15,050	10,460	13,770
$80,000.........................	20,120	20,900	16,920	19,300	13,960	17,820
$100,000.......................	30,220	31,120	26,220	29,120	22,460	27,240
$200,000.......................	80,720	87,590	78,720	83,590	70,960	79,710

$500,000......................	263,720	264,560	243,720	254,560	223,960	244,680
$1,000,000....................	571,220	572,040	531,220	552,040	491,460	532,160
			MARRIED MAN, NO DEPENDENTS.			
$3,000..	$20	$8	$0	$0	$0	$0
$3,500..	40	26	0	0	0	0
$4,000..	60	44	0	0	0	0
$4,500..	80	62	0	0	0	0
$5,000..	100	80	0	0	0	0
$6,000..	140	116	20	8	0	0
$7,000..	210	172	50	46	10	20
$8,000..	300	248	80	104	20	60
$9,000..	390	324	110	162	30	100
$10,000......................................	480	400	140	220	40	140
$12,000......................................	680	587	220	351	80	235
$14,000......................................	900	754	340	502	140	350
$16,000......................................	1,140	961	500	673	220	485
$18,000......................................	1,400	1,188	680	864	320	640
$20,000......................................	1,680	1,450	880	1,000	440	830
$25,000......................................	2,520	2,300	1,520	1,830	880	1,480
$30,000......................................	3,480	3,330	2,280	2,750	1,440	2,310
$40,000......................................	5,800	5,695	4,200	4,895	2,960	4,275
$50,000......................................	8,600	8,585	6,600	7,585	4,960	6,765
$60,000......................................	11,900	11,955	9,500	10,755	7,460	9,735
$70,000......................................	15,700	15,820	12,900	14,420	10,460	13,200
$80,000......................................	20,000	20,210	16,800	18,610	13,960	17,190
$100,000....................................	30,100	30,310	20,100	28,310	22,460	26,490
$200,000....................................	86,600	86,735	78,600	82,735	70,960	78,915

$500,000....................................	263,600	263,660	243,600	253,000	223,960	243,840
$1,000,000..................................	571,100	571,110	531,100	551,110	491,460	531,290

An examination of these two tables reveals that the tax on ordinary income is not changed to a consequential extent, except that a very moderate reduction in tax is given to taxpayers with small amounts of earned income. On the other hand, the tax on income derived from dividends and partially tax-exempt Government bonds is substantially increased, although the tax on this class of income will still be materially less than on earned income of equal size. It is believed this increase can well be borne both in the case of dividend income and in the case of income from partially tax-exempt securities.

It is believed that the changes in the tax-rate structure of the income tax proposed by your committee will result in substantial additional revenue, and at the same time distribute the tax burden more equitably.

(4) DEPRECIATION.

In the report to the House on the revenue bill of 1934, the subject of depreciation was discussed. It was pointed out that an arbitrary reduction of 25 per cent in the amount of the depreciation allowances for a 3-year period had been considered, but that this legislation had been abandoned in favor of a plan presented by the Secretary of the Treasury having for its object the reduction of these allowances by administrative action. The following quotation from a letter of the Secretary to the chairman of the Committee on Ways and Means shows the essential elements of this plan:

“It is intended that this end shall be accomplished, first, by requiring taxpayers to furnish the detailed schedules of depreciation (heretofore prepared by the Bureau), containing all the facts necessary to a proper determination of depreciation; second, by specifically requiring that all deductions for depreciation shall be limited to such amounts as may reasonably be considered necessary to recover during the remaining useful life of any depreciable asset the unrecovered basis of the asset; and, third, by amending the Treasury regulations to place the burden of sustaining the deductions squarely upon the taxpayers, so that it will no longer be necessary for the Bureau to show by clear and convincing evidence that the taxpayers' deductions are unreasonable. These changes will increase the revenue substantially, and, although difficult to estimate, records indicate that the amount of the increase in revenue will equal that which would result from the proposal of the Ways and Means Committee.”

Your committee is heartily in favor of the reduction of unreasonable allowances for depreciation, and includes in its estimates $85,000,000 annually of additional revenue from the Secretary's proposal. This is the same amount carried in the House report on the bill.

(5) CAPITAL GAINS AND LOSSES.

The House report contains the following general statement with respect to the new plan proposed for the treatment of capital gains and losses for income-tax purposes:

“Existing law provides in section 101 for a special treatment of the gains and losses resulting from the sale of capital assets held over two years. The tax on gains on such sales is limited to 12 ½ per cent, with a corresponding limitation in case of losses. In the case of assets held less than two years, the gains are taxed in full and the losses allowed in full except in the case of stocks and bonds, losses from which are limited under section 23(r).

“Our present system has the following defects:

“First. It produces an unstable revenue--large receipts in prosperous years, low receipts in depression years.

“Second. In many instances, the capital-gains tax is imposed on the mere increase in monetary value resulting from the depreciation of the dollar instead of on a real increase in value.

“Third. Taxpayers take their losses within the 2-year period, and get full benefit therefrom, and delay taking gains until the 2-year period has expired, thereby reducing their taxes.

“Fourth. The relief afforded in the case of transactions of more than two years is inequitable. It gives relief only to the larger taxpayers with net incomes of over $16,000.

“Fifth. In some instances, normal business transactions are still prevented on account of the tax.

“Your committee has examined the British system, which disregards these gains and losses for income-tax purposes. The stability of the British revenue over the last 11 years is in marked contrast to the instability of our own. In that period the maximum British revenue was only 35 per cent above the minimum, while in our own case the variation was 280 per cent.

“Your committee, however, has been unable to reach the conclusion that we should adopt the British system. It is deemed wiser to attempt a step in this direction without letting capital gains go entirely untaxed. Your committee recommends the following plan:

“First. To measure the gain or loss from the sale of property by an individual according to the length of time he has held the property, only the following percentages of the recognized gain or loss are taken into account for tax purposes:

“One hundred per cent if the capital asset has been held for not more than one year;

“Eighty per cent if the capital asset has been held for more than one year but not more than two years;

“Sixty per cent if the capital asset has been held for more than two years but not more than five years; and

“Forty per cent if the capital asset has been held for more than five years.

“Second. In the cases where the losses taken into account as above exceed the gains so taken into account, the excess losses are entirely disallowed.

“Third. In the case of corporations the graduated percentage reduction of gains and losses does not apply. However, capital losses sustained by corporations are allowed only to the extent of capital gains. Under the present law corporations are allowed to offset capital losses against ordinary income.

“Fourth. The plan outlined above is not made applicable, for obvious reasons, to stock in trade or property which is included in the taxpayer's inventory.

“It is believed that the adoption of this plan (see section 117 of the bill) will result in much greater stability in revenue, will give all taxpayers equal treatment, will encourage normal business transactions, and will yield substantially greater revenue. The method proposed is safe from a revenue standpoint, inasmuch as capital losses can not be used to reduce ordinary income, while gains are taxed in full or in part in proportion to the time for which the property has been held. The existing method which has been in force since 1921 can be defended only on the ground of expediency.”

Your committee concurs in the general features of the plan proposed by the House bill, but believes a few modifications should be made therein. Reference to section 117 of the bill dealing with capital gains and losses will reveal the following changes in respect to the House bill:

First, an additional bracket is added to the schedule providing for the percentages of gains or losses to be taken into account in computing net income. This additional bracket provides for taking into account 30 per cent of the gain or loss if the asset has been held for over 10 years. Under the House bill 40 per cent of the gain or loss was taken into account in the case of assets held for more than 5 years. It is believed this change is proper in order that normal business transactions may not be prevented and in order that long-term losses may not eliminate from tax speculative short-term gains. Moreover, as far as the 30 per cent rate on gains is concerned, the use of this rate can not reduce the tax by more than 70 per cent. Under existing law the 12 ½ per cent rate may bring about a tax reduction as great as 80 per cent.

Second, the definition of capital assets has been slightly revised to prevent tax avoidance by excluding from the category of a capital asset “property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business,” instead of merely “property held by the taxpayer primarily for sale in the course of his trade or business.”

Third, in the case of the general limitation provided in the House bill that capital losses should only be allowed to the extent of the capital gains, your committee recommends that $2,000 of such excess of losses may be charged off from ordinary income. This protects the little taxpayer with little or no capital from being assessed a tax which he may be unable to pay. Your committee also recommends, in view of the necessary dealings of the banks and trust companies in bonds and other evidences of indebtedness of corporations and governments, that such banks and trust companies be permitted to deduct from ordinary income the loss resulting from the sale of such obligations in an amount not greater than the difference between the sale price and the par or face value.

Fourth, to prevent tax avoidance in the case of capital losses, and to prevent discrimination in respect to capital gains against taxpayers living at a distance from the stock market, subdivision (e) of section 117 has been entirely rewritten. Under the House bill, a man with a long-term loss could change it into a short-term loss and utilize it against his gains to the full 100 per cent by simply making a short sale. On the other hand, a man living in some distant city who desired to sell some stock he had held for five years would have to pay a tax on 100 per cent of the profit if he wired his order for the immediate sale of such stock. Both of these inequitable results are remedied by the bill as reported.

Substantially increased revenues are expected from this new system of treating capital gains and losses. The changes made are either to prevent tax avoidance or to bring about greater equity. No consequential amount of revenue is lost by these changes. It should be noted that all persons other than corporations are affected by the percentage brackets, including individuals, partnerships, and trusts. The limitation on losses contained in section 117(d) applies to all persons.

(6) PERSONAL HOLDING COMPANIES.

The House report contains the following significant statement with respect to personal holding companies:

“Perhaps the most prevalent form of tax avoidance practiced by individuals with large incomes is the scheme of the ‘incorporated pocketbook.’ That is, an individual forms a corporation and exchanges for its stock his personal holdings in stock, bonds, or other income-producing property. By this means the income from the property pays corporation tax, but no surtax is paid by the individual if the income is not distributed.

“For instance, suppose a man has $1,000,000 annual income from taxable bonds. His tax under existing law will be $571,100. However, if he forms a holding company to take title to the bonds and to receive the income therefrom, the only tax paid will be a corporate tax of $137,500 as long as there is no distribution of dividends. Thus a tax saving of $433,060 has been effected.

“It is true that section 104 of the existing income-tax law puts a 50 per cent penalty on this accumulation of profits to avoid surtaxes, but, nevertheless, there seems no doubt that this form of avoidance is still practiced to a large extent. By making partial distribution of profits and by showing some need for the accumulation of the remaining profits, the taxpayer makes it difficult to prove a purpose to avoid taxes.”

Your committee is of the opinion that it is extremely important to prevent this type of tax avoidance. While agreeing with the general method proposed in the House bill to remedy this situation, it is believed that section 102 of the House bill dealing with personal holding companies imposes a heavy penalty on many companies which do not properly fall into the classification of the “incorporated pocketbook.”

In view of this situation, your committee has rewritten the section dealing with personal holding companies and has placed it in Title IA, section 351, and it has been made plain that this is an additional graduated income tax, or surtax, on personal holding companies.

It is proposed to impose a surtax of 30 per cent on the first $100,000 of the undistributed adjusted net income of a personal holding company plus 40 per cent of the amount of such undistributed adjusted net income as is in excess of $100,000. Under section 1 of the bill incorporated by reference in this section, the tax will apply to all taxable years beginning after December 31, 1933. The House bill provides for one flat rate of 35 per cent. It is believed that the change recommended by your committee is important in order that partially tax-exempt interest from Government obligations and from obligations of certain corporate instrumentalities of the United States may be included in the income of these companies subject to this surtax. These partially tax-exempt bonds are issued free of all taxes except additional graduated income taxes, or surtaxes, and excess-profits taxes. There is some doubt whether the House provision effectively includes such partially tax-exempt interest. There can be no such doubt in respect to the provision now in the bill as reported.

A personal holding company is defined as any corporation 80 per cent of whose gross income for the taxable year is derived from royalties, dividends, interest, annuities, and gains from the sale of stock or securities, and more than 50 per cent in value of whose outstanding stock is owned by not more than five individuals during the last half of the taxable year. In computing the number of individuals who own the majority of the voting stock of a corporation it is proposed to count as one all members of a family in the direct line as well as the spouse and brothers and sisters. The House bill includes in the income within the 80 per cent clause income from “rents.” A great part of real estate business is done by small family corporations. These partake more of the nature of operating companies than mere holding companies. Your committee is of the opinion that it is unwise to include such companies within the category of personal holding companies. Therefore, the word “rents” is omitted from the definition.

In arriving at the tax basis for personal holding companies, the “adjusted net income” is first computed. This is accomplished by adding to the net income, the amount of dividends received from domestic corporations and subtracting from this sum the amount of the income tax imposed by Title I plus contributions or gifts not otherwise allowed as a deduction under Title I.

The “undistributed adjusted net income” to which the tax attaches is computed by subtracting from the “adjusted net income,” described above, the following amounts:

(A) 10 per cent of the excess of the adjusted net income over the amount of domestic dividends received;

(B) a reasonable amount used or set aside to retire indebtedness incurred prior to January 1, 1934; and

(C) dividends paid during the taxable year.

These definitions of “adjusted net income” and “undistributed adjusted net income” have been somewhat modified with respect to the definitions carried in the House bill. In the House bill the excess of capital losses over capital gains disallowed by section 117(d) was permitted as a deduction from the adjusted net income. Your committee has eliminated this provision which allows the personal holding company a loss not permitted other persons for income-tax purposes. Although the wording of the section has been changed, both the House bill and the bill as now reported include in income subject to tax, interest on partially tax-exempt obligations of the United States. The change in wording is made necessary through a change in the structure of the House bill explained in connection with section 26.

With respect to the undistributed net income, the arbitrary 10 per cent of the adjusted net income allowed by the House bill to be accumulated by the company free of the surtax has been further limited so as to allow only 10 per cent of the excess of the adjusted net income over the amount of domestic dividends received. This change is necessary in order to prevent tax avoidance by a chain of holding corporations. Considerable hardship has been avoided by permitting the deduction from the adjusted net income of a reasonable amount used or set aside to retire indebtedness incurred prior to January 1, 1934. This will substantially and properly relieve personally owned corporations which have outstanding bonds or other indebtedness that must be met from current earnings before distributions can be made.

The House bill exempted from the operation of this provision banking and insurance corporations. Your committee has restricted this exemption to banks and trust companies incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, and to life insurance companies. Corporations exempt from income tax are, of course, exempt from this surtax.

The foreign tax credit allowed under section 131 of Title I of the bill is not allowed in the case of the surtax on the personal holding company. It appeared that the House bill allowed such a credit. The consolidated return is permitted for the purposes of this section both under the House bill and under the bill as reported by your committee. It appears that the consolidated return in this case prevents rather than encourages tax avoidance.

Many will consider the surtax imposed on these personal holding companies a harsh measure. However, a corporation which falls within this section because of the nature of its business and the number of its stockholders can always escape this tax by distributing to its stockholders at least 90 per cent of its adjusted net income. The stockholder will, of course, be subject to the graduated surtaxes upon such distributions. Thus, the section should work no real hardship upon any corporation except one which is being used to reduce surtaxes upon its shareholders.

The effect of this system is to provide for a tax which will be automatically levied upon the holding company without any necessity for proving a purpose of avoiding surtaxes. It is believed that the majority of these corporations are in fact formed for the sole purpose of avoiding the imposition of the surtax upon the stockholders.

The fact that some companies, such as real estate companies, have been placed outside the scope of this provision does not result in a serious opportunity for tax avoidance. Such companies, and, in fact, all other corporations, are still subject to section 102 of the bill. That section is similar to section 104 of existing law and applies a surtax to any corporation formed or availed of for the purpose of preventing imposition of surtaxes upon its shareholders. Some changes have been made in this section and these are described in the latter part of this report.

Your committee believes that the imposition of a surtax on personal holding companies created to defeat the operation of the surtax on individuals is of the utmost importance and that it will result, directly or indirectly, in substantially increasing the revenues of the Government.

(7) EXCHANGES AND REORGANIZATIONS.

The House bill retains the exchange provisions of the present law, but limits the application of the reorganization provisions in two ways. In the first place, section 112(g) of the existing law is omitted from the bill. This paragraph provides that a corporation by means of a reorganization may distribute to its shareholders stock or securities in another corporation a party to the reorganization without any tax to the shareholders. By this method corporations have found it possible to pay what would otherwise be taxable dividends, without any taxes upon their shareholders. Your committee agrees that this means of avoidance should be eliminated, and, therefore, approves this change.

In the second place, the House bill climinates from the definition of "reorganization" as it appears in the present law the parenthetical phrase appearing after the words "merger or consolidation," which reads as follows: "(including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation)."

The House report states:

"In the second place, the definition of a reorganization has been restricted so that the definition will conform more closely to the general requirements of corporation law, and will limit reorganizations to (1) statutory mergers and consolidations; (2) transfers to a controlled corporation, 'control' being defined as an 80 per cent ownership; and (3) changes in the capital structure or form of organization.

"By these limitations the committee believes that it has removed the danger that taxable sales can be cast into the form of a reorganization, while at the same time, legitimate reorganizations, required in order to strengthen the financial condition of the corporation, will be permitted. Furthermore, the retention of the other reorganization provisions will prevent large losses from being established by bondholders and stockholders who receive securities in a newly reorganized enterprise which are substantially the same as their original investments."

Your committee is in complete agreement with the purposes of the House bill which aim at tax-avoidance schemes in this connection. However, some modifications are recommended in order to bring about a more uniform application of the provisions in all 48 of the States. Not all of the States have adopted statutes providing for mergers or consolidations; and, moreover, a corporation of one State can not ordinarily merge with a corporation of another State. The committee believes that it is desirable to permit reorganizations in such cases, with restrictions designed to prevent tax avoidance. Consequently, the committee recommends the insertion in the House bill of an addition to the definition of the term "reorganization" as follows:

"(B) the acquisition by one corporation in exchange solely for its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation;"

The committee believes that these transactions, when carried out as prescribed in this amendment, are in themselves sufficiently similar to mergers and consolidations as to be entitled to similar treatment. It will be noted that the proposed amendment requires that (1) the acquiring corporation must obtain at least 80 per cent of the voting stock and at least 80 per cent of the total number of shares of all other classes of stock of the other corporation, instead of only a majority as provided by the present law; and

(2) the acquisition, whether of stock or of substantially all the properties, must be in exchange solely for the voting stock of the acquiring corporation.

Your committee approves the retention of the exchange and reorganization provisions with these changes. Reorganizations are now being consummated in the majority of cases to reduce the capital structure, and to strengthen the financial condition of the participating corporations. If the reorganization provisions were omitted from the bill, many stockholders and bondholders could take large losses, although they might retain substantially their former interests in the enterprise. Hence, the Treasury has little or nothing to gain by the elimination of these provisions, while, on the other hand, some legitimate and desirable business readjustments would be prevented.

(8) CONSOLIDATED RETURNS.

Except for a clarifying change in the consolidated-returns section (section 141), your committee recommends adopting the provisions of the House bill respecting these returns in their entirety. The statement in the House report on the bill, therefore, is applicable to the bill as reported by your committee, the clarifying amendment noted being described in the latter part of this report. The statement in the House report is as follows:

“Section 141 of existing law permits corporations, which are affiliated through 95 per cent stock ownership, to file consolidated returns.

“The subject of consolidated returns has long been in controversy. The revenue bill of 1918, as passed by the House, prohibited the consolidated return which had been previously allowed under the regulations of the Treasury Department. The bill as passed by the Senate and finally enacted specifically provided for the consolidated return. The revenue bill of 1928, as passed by the House, denied the right to file consolidated returns, but this provision was eliminated in the Senate. During the consideration of the revenue bill of 1932 a compromise was effected resulting in the levying of an additional tax of three-fourths of 1 per cent on the consolidated net income. This additional tax was increased to 1 per cent by the National Industrial Recovery Act.

“It can not be denied that the privilege of filing consolidated returns is of substantial benefit to the large groups of corporations in existence in this country. This is especially true in depression years, for the effect of the consolidated return is to allow the loss of one corporation to reduce the net income and tax of another, and during a depression more losses occur. Another effect of the consolidated return may be to postpone tax. This is because there is no profit recognized for tax purposes on intercompany transactions, and profits on a product of the consolidated group, passing through the hands of the different members of the group, are not taxed until the product is disposed of to persons outside the group.

“In the past, when any corporation could carry forward a net loss from one year to another, the consolidated group did not have such a great advantage over the separate corporation. Now that this net loss carry-over has been denied, the advantage of the consolidated return is much greater on a comparative basis.

“The importance of the matter may be seen from the following figures which show the relation between the gross income of all corporations and corporations filing consolidated returns:

Year.	**Gross income.**		**Percentage of total gross income shown on consolidated returns.**
	All corporate returns.	**Consolidated returns.**	
			Per cent.

1928.......	$157,254,907,731	$69,825,396,448	44.4
1929.......	160,621,509,181	72,456,327,976	45.1
1930.......	138,312,059,068	65,966,147,467	47.6
1931.......	107,515,239,037	50,244,116,910	46.7

“Your committee considered at length the question of abolishing the consolidated return. Our subcommittee originally recommended this action. The Treasury believed this policy undesirable. The Treasury pointed out that the one way to secure a correct statement of income from affiliated corporations is to require a consolidated return, with all intercompany transactions eliminated. Otherwise, profits and losses may be shifted from one wholly owned subsidiary to another, and their separate statements of income do not present an accurate picture of the earnings of the group as a whole. For all practical purposes the various subsidiaries, though technically distinct entities, are actually branches or departments of one enterprise. For these reasons, consolidated statements of income have been the rule for ordinary business purposes, and for 16 years, the income tax law has provided for consolidated returns. The administration of the income tax law is simpler with the consolidated return since it conforms to ordinary business practice; enables the Treasury to deal with a single taxpayer instead of many subsidiaries; and eliminates the necessity of examining the bona fides of thousands of intercompany transactions.

“Consequently, after careful consideration of the question, the committee decided that it would be undesirable to abolish the consolidated return at this time. It appeared in the hearings that such action would be especially burdensome to many corporations, such as the railroads, which are frequently obliged to maintain separate corporate structures in the several States in which they operate, although for all ordinary business and accounting purposes, the subsidiaries form a single operating system. Moreover complete data are not yet available as to consolidated returns for 1932, when the 1 per cent differential was first imposed upon corporations filing such returns. In view of the advantages obtained by corporations exercising the privileges of filing consolidated returns, however, the committee concluded that an additional tax of 2 per cent should be levied on corporations availing themselves of this option, instead of the 1 per cent provided by the present law. The Treasury estimates that under present conditions this plan will bring in more revenue than the abolition of the consolidated return.”

(9) PARTNERSHIPS.

The House bill proposes certain changes in existing law to prevent tax avoidance by partnerships. Your committee recommends the adoption of the provisions carried in the House bill without change. The House report describes the changes proposed in existing law as follows:

“The subcommittee and the committee have made a careful study of the taxation of partnerships. It has been strongly contended that many large partnerships, particularly those engaged in the banking and security business, have been the vehicle of widespread tax avoidance. It has been pointed out that wealthy partners have applied partnership losses against their individual incomes, with the result that in some of the past few years they have paid no individual income taxes. If any avenue of escape from the income tax through the use of the partnership provisions has been left open in the past, it is important that it should be completely closed at this time.

“The committee found that the principal loss of revenue from partnerships in the last few years had occurred by reason of the fact that the partnerships in question had realized losses from the sales of securities which the individual partners were permitted to deduct against their income from other sources. Of course, these partners were compelled to pay normal taxes and surtaxes upon the partnership profits in its prosperous years; and in most cases, these taxable profits have far exceeded the deductible losses recently allowed. The revenues will be safeguarded in the future, however, by the application of the new capital gain and loss provisions to partnerships. Under the bill, the partnership will be permitted to deduct losses on the sale of capital assets only to the extent of gains from such sales (section 117(d)). Thus the partnership can have no capital net loss and therefore the partner can have no deduction on account of any capital loss of the partnership. In this way the main source of the tax avoidance by banking and security partnerships in the past can be eliminated.

“The committee also proposes two important changes in connection with the basis provisions, for the purpose of making it entirely certain that there can be no use of the partnership as a medium of tax avoidance in cases of sales of property which has appreciated in value. The result of the provisions of section 113(a) 13 is that if property is purchased by a partnership the basis of such property to the partnership shall be its cost; but if the property is paid in by a partner then the basis to the partnership shall be the cost or other basis to the partner. The committee believes that this provision simply makes specific the correct interpretation of the general provisions of the present law. Paragraph (13) further provides that if property is distributed in kind by a partnership to a partner, the basis to the partner shall be a proper proportionate part of the cost or other basis to him of his interest in the partnership. An example will make the operation of this proposal clear. Suppose that a partner, A, paid $10,000 for his interest in a partnership. Suppose that the partnership distributes to the partners property in kind representing one-half of its assets. irrespective of the value of this property at the time of its distribution, the basis to A of the property distributed to him will be $5,000, and he will be taxed on any amount for which he thereafter disposes of the property in excess of $5,000. The committee believes that this provision embodies merely the correct interpretation of the present law but it appears desirable to have an express statement of the rule in the statute.

“By means of these changes in the partnership provisions, the committee believes that a considerable amount of additional revenue will be obtained by the Treasury directly and indirectly without any injustice to the numerous small partnerships which exist throughout the country. On the other hand, the committee believes that it has eliminated the opportunities for tax avoidance which its investigations and the investigations of other congressional committees have disclosed.”

(10) GASOLINE AND LUBRICATING OIL (ADMINISTRATIVE CHANGES).

Section 603 of the House bill amended sections 601(c)1 and 617 of the Revenue Act of 1932 so as to eliminate the privilege of selling gasoline and lubricating oil tax-free for use in further manufacture of taxable articles or for resale to a State or municipality. Upon proof of payment of a second tax on the gasoline or lubricating oil or any article into which it entered, or proof that the gasoline or lubricating oil had been resold to a State or political subdivision thereof, credit or refund was to be allowed of taxes paid on prior sales.

Your committee is convinced that the changes made by the House bill are too drastic and that the difficulty of tracing the identity of particular lots of gasoline and lubricating oil would make the system under the House bill unsatisfactory in operation. It is also believed to be unfair to burden all manufacturers with a system involving the tying up of their funds in duplicate tax payments and the filing of numerous claims for credit or refund in order to eliminate this duplication of taxes. It appears that the evasion which has resulted from the abuse of the provisions for tax-free sales can be met without entirely revising the administration of these taxes. With this end in view, section 603 has been completely rewritten and the following changes from the House bill have been made:

(1) The definition of gasoline has been amended to tax all naphthas unless sold specifically for a nonmotor-fuel use. This provision will go far in eliminating the tax loss that has resulted from the diversion to motor-fuel uses of so-called industrial naphthas sold tax-free under such names as “painter's naphtha,” “cleaner's naphtha,” etc.

(2) The provisions of the House bill requiring registration and bonding of all manufacturers and producers of gasoline and lubricating oil have been retained. In addition, the Commissioner is authorized to revoke the registration, and right to buy tax-free, of any manufacturer or producer who is guilty of tax evasion. It is believed that these provisions will be sufficient to insure

collection of tax due from irresponsible and fly-by-night manufacturers and producers and to eliminate the abuse of the tax-free sales which in the past has resulted in considerable loss of revenue.

(3) A provision has been inserted providing for the furnishing of information from Federal returns to State officers. It is believed that this provision will result in more effective cooperation between Federal and State officers in the enforcement of their respective gasoline and lubricating oil taxes. Information furnished by State officers has been helpful in enforcing the Federal taxes, but under existing law Federal officers are not permitted to reciprocate.

Substantial additional revenue is expected from the provisions contained in the bill as reported through the prevention of tax evasion in respect to these taxes.

(11) MODIFICATIONS AND ELIMINATIONS (SPECIAL EXCISE TAXES).

Our excise-tax system is burdensome and discriminatory. Nearly all our excise taxes are temporary in character and will be repealed automatically as of July 1, 1935. However, the inequities and administrative difficulties in the case of some of these taxes are such that the following modifications or eliminations are recommended immediately:

The tax on soft drinks should be entirely eliminated. (See section 601.) This tax is an administrative nuisance and is adversely affecting business. Moreover, this industry is in competition with fermented liquors. The cost of this elimination will be about $6,100,000 in the fiscal year 1935.

The tax on clocks should be entirely eliminated. (See section 608.) These products are now taxed as jewelry, although they are not properly jewelry in any sense. The tax is adversely affecting this business. The cost of this elimination is only $100,000 for 1935.

The tax on produce futures should be reduced from the present rate of 5 cents per $100 to the old rate of 1 cent per $100. (See section 611.) The present high rate of tax is detrimental to the establishment of a stable market price for produce. This reduction will not cost more than $3,300,000 for 1935.

The tax on furs should not apply to articles made of fur selling for less than $20. (See section 607.) The fur tax is one of the most difficult of all our taxes to administer and is creating double taxation on the industry. The cost of this reduction in 1935 should not exceed $4,000,000.

The tax on colored stem wooden matches should be increased from 2 cents per 1,000 to 5 cents per 1,000. (See section 610.) Through an error in the Tariff Act, these matches bear a much lower duty than uncolored stem matches. The result is that our own manufacturers can not fairly compete in the wooden match field, since the cost of coloring the stems is negligible. The change in this excise tax will tend to remedy this defect in the Tariff Act. The additional revenue should be about $1,500,000 in 1935.

The check tax was repealed prospectively in the House bill as of January 1, 1935. (See section 606 of the House bill.) Your committee believes the repeal of this tax should be delayed until July 1, 1935. The additional revenue resulting from this action will amount to about $22,000,000 in the fiscal year 1935.

Since the rate of the new coconut oil processing tax has been reduced in the bill from 5 cents per pound to 3 cents per pound, a loss in revenue on this account of $8,000,000 may be expected.

As a result of the changes proposed above, there is net gain in revenue of about $2,000,000 in the fiscal year 1935. All these changes are described in detail in the latter part of this report.

GENERAL REMARKS.

It is the opinion of your committee that the amendments proposed in this bill to existing law will accomplish the following objects:

(1) A substantial increase in the revenue.

(2) Effective prevention of tax avoidance.

(3) A more stable revenue, both in years of prosperity and years of depression.

(4) A more equitable excise-tax system.

(5) Less administrative difficulties.

The remainder of this report will be devoted to a description of each section of the bill in order. Many of the changes not described in the preceding pages of this report will be found of considerable importance. Your committee has held hearings on the bill and believes that it is fair to the taxpayer without being lenient.

TECHNICAL AND ADMINISTRATIVE PROVISIONS.

TITLE I. INCOME TAX.

SECTION 1. APPLICATION OF TITLE.

The House bill follows the general plan and arrangement of the Revenue Act of 1932. The income-tax title is made applicable to taxable years beginning after December 31, 1933. This represents a change in policy in respect to fiscal-year returns. Under the Revenue Act of 1932, the income-tax title was made applicable to fiscal-year returns ending during the first calendar year (1932). Under sections 14 and 105 of the Revenue Act of 1932, the tax on such returns was first computed under the provisions and rates of the Revenue Act of 1928 and then under the provisions and rates of the Revenue Act of 1932. The final tax imposed for a fiscal year of 12 months was then found by taking the sum of (1) the same proportion of the tax computed under the Revenue Act of 1928 as the number of months falling in 1931 was to 12 months, and (2) the same proportion of the tax computed under the Revenue Act of 1932 as the number of months falling in 1932 was to 12 months. This complicated rule has been eliminated in the proposed bill for the purpose of simplicity and ease of administration. The proper changes have been proposed in other sections of the bill to effectuate the new plan, which applies the provisions of the bill to all taxable years (whether calendar or fiscal) beginning after December 31, 1933. Your committee made no change in this section of the House bill.

SECTION 11. NORMAL TAX ON INDIVIDUALS.

The change made by the House in this section was designed to carry out the general plan for an improved tax-rate structure as already, described in the first part of this report. It provides for one normal rate of 4 per cent upon the net income (in excess of the allowable credits) of every individual in lien of the graduated rates of 4 per cent and 8 per cent provided in existing law. Your committee made no change in this section of the House bill.

SECTION 12. SURTAX ON INDIVIDUALS.

The changes made by the House in this section are also necessary in order to carry out the general plan for an improved tax-rate structure as already described in the first part of this report. The existing surtax table containing 53 brackets is replaced by a new surtax table containing only 28 brackets. The rates are approximately 4 points higher than under existing law to make up for the elimination of the 8 per cent normal rate and the use of one 4 per cent normal rate on all amounts of income. It should also be observed that the new surtax rates apply to “surtax net income” instead of net income as at present. Surtax net income is defined as net income less the personal exemption and credits for dependents. However, surtaxes will start at $4,000 under the proposed schedule instead of at $6,000 as under existing law, which compensates for this change. The remaining changes made by the section are in connection with cross-references, which will be described when the sections referred to are reached. Your committee made no changes in this section of the House bill.

SECTION 13. TAX ON CORPORATIONS.

These are merely clerical changes. The first is made necessary by the action taken in restoring section 26 of existing law. The other changes are made in cross-references occasioned by the action taken in subsequent sections.

SECTION 14 (REVENUE ACT OF 1932). TAXABLE PERIOD EMBRACING YEARS WITH DIFFERENT LAWS.

Since the policy of treating fiscal years has been changed in section 1, this section was omitted by the House. Your committee concurs in this omission.

SECTION 22(A). GROSS INCOME--GENERAL DEFINITION.

This is merely a clerical change made by the House. It is made necessary to carry out the policy adopted in the Revenue Act of 1932 of taxing the salaries of Presidents and judges taking office after June 6, 1932, the date of the enactment of that Act. Your committee made no change in this section of the House bill.

SECTION 22(B)1. LIFE INSURANCE.

This change, made by the House, makes it clear that the proceeds of a life insurance policy payable by reason of the death of the insured in the form of an annuity are not includible in gross income. Your committee made no change in this section of the House bill.

SECTION 22(B)2. ANNUITIES.

The present law does not tax annuities arising under contracts until the annuitant has received an aggregate amount of payments equal to the total amount paid for the annuity. Payments to annuitants are, in fact, based upon mortality tables which purport to reflect a rate of return sufficient to enable the annuitant to recover his cost, and in addition thereto, a low rate of return on his investment.

The House bill continues the policy of permitting the annuitant to recoup his original cost tax-free but requires him to include in his gross income a portion of the annual payments in an amount equal to 3 per cent of the cost of the annuity. While your committee is in agreement with the change made by the House, it was thought advisable to continue the policy of not taxing any portion of the amount received from an annuity until the aggregate amount of payments equal the total amount paid for the annuity in cases where the aggregate amount received by the annuitant from all his annuities is not more than $500. The following example illustrates the change made:

Example: "A," an individual, received during the calendar year the following amounts from annuities: Annuity No. 1, $450; annuity No. 2, $300; and annuity No. 3, $150. In the case of annuity No. 1, "A" prior to 1934 received aggregate payments equal to the aggregate premiums paid. In the case of annuity No. 1, "A" reports the entire amount of the annuity because all of his capital has been returned. In the case of annuity No. 2 and annuity No. 3, "A" is required to include in gross income 3 per cent of the consideration paid for each such annuity. The $500 exemption will not apply in such a case because the total annuity payments received by "A" during the taxable year exceed that amount.

SECTION 22(B)4. TAX-FREE INTEREST.

This is merely a clarifying change made by the House. Under the language of this section, as contained in existing law, interest on securities issued under the Federal Farm Loan Act, or such Act as amended, is expressly excluded from gross income and thereby made exempt from the income tax. Other Acts have been enacted which also exempt the interest on obligations issued thereunder from tax. In order to bring the section into accord with the Acts authorizing such exemptions and to avoid the necessity of referring to all such Acts, a general provision has been inserted by the House excluding from gross income the interest upon the obligations of a corporation organized under Act of Congress if such corporation is an instrumentality of the United States; subject to the limitation, however, that the interest is exempt only to the extent provided for in the Acts of Congress authorizing the issuance of such obligations. Your committee made a change in this section of the House bill which is described under section 26.

SECTION 22(E). DETERMINATION OF GAIN OR LOSS.

This is a clerical change made by the House. The computation of gain or loss is provided for in section 111 only. The references to sections 112 and 113 are, therefore, unnecessary and your committee concurs in this change made by the House.

SECTION 23(B). DEDUCTIONS FROM GROSS INCOME--INTEREST.

Section 23(b) of existing law prohibits the deduction of interest paid or accrued on indebtedness incurred or continued to purchase or carry tax-exempt securities. The indebtedness incurred by a bank to its depositors is not treated under existing law as indebtedness incurred or continued to purchase or carry tax-exempt securities. This section of the House bill provides that if the proceeds of indebtedness, such as bank deposits, are actually used to purchase or carry tax-exempt securities, no deduction shall be allowed for the interest incurred on such indebtedness. Your committee is of the opinion that the change made by the House bill will seriously interfere with the marketing of Government securities, which are bought for the most part by banks and financial institutions, and also presents grave administrative difficulties. Your committee, therefore, disagrees with the change made in this section by the House bill and recommends that the provisions of existing law be continued.

The existing law also prohibits the deduction with respect to interest paid or accrued on indebtedness incurred or continued to purchase or carry an annuity. The House bill enlarges this prohibition to apply if the proceeds of the indebtedness are actually used in purchasing or carrying an annuity. The theory for not allowing the deduction in such cases is that, since the annuitant was not required to report annuity payments as income (until they exceeded his capital investment), he ought not to be permitted to reduce his taxable income by the allowance of such a deduction. However, since the annuitant is required under the bill to include in income a certain part of the annuity payment received each year, your committee is of the opinion that the reason for denying the interest deduction in such cases no longer exists. Accordingly, your committee recommends the omission from the bill of the provision prohibiting the deduction of interest "on indebtedness incurred, or continued, or the proceeds of which were used, in connection with the purchasing or carrying of an annuity."

SECTION 23(C). TAXES.

Paragraph (1) of the House bill involves no change of policy, but restates the present law more clearly.

Paragraph (3) of the House bill denies the deduction allowed under existing law for estate, inheritance, legacy, succession, and gift taxes. These taxes constitute expenses which are not incurred in the production of income. They constitute, in fact, mere charges imposed upon the transfer of capital. Your committee made no changes in these paragraphs of the House bill.

SECTION 23 (E) AND (F).

These subsections are the same as existing law except for clerical changes.

SECTION 23(G). WAGERING LOSSES.

Existing law does not limit the deduction of losses from gambling transactions where such transactions are legal. Under the interpretation of the courts, illegal gambling losses can only be taken to the extent of the gains on such transactions. A similar limitation on losses from legalized gambling is provided for in the House bill. Under the present law many taxpayers take deductions for gambling losses but fail to report gambling gains. This limitation will force taxpayers to report their gambling gains if they desire to deduct their gambling losses. Your committee makes no change in this section of the House bill.

SECTION 23(H). BASIS FOR DETERMINING LOSS.

The present law provides that the basis for determining the deduction for losses sustained under subsection (e) or (f) shall be the adjusted basis for determining gain or loss from the sale or other disposition of the property. Inasmuch as under the House bill the adjusted basis for gain on disposition of the property may be different from that for loss, the House bill provides that the basis for losses under subsection (e) or (f) shall be the adjusted basis for determining loss from the sale or other disposition of property. Your committee makes no change in this section of the House bill.

SECTION 23(J). CAPITAL LOSSES.

This provision is an important part of the new policy recommended for the treatment of capital gains and losses from the sale or exchange of property, as already described. It makes it clear that individuals and corporations are entitled to deduct capital losses only to the extent provided in section 117. Your committee makes no change in this section of the House bill.

SECTION 23(M). DEPLETION.

The proposed bill states specifically that the deduction for depletion is allowable under this section instead of under section 114(b). Your committee made no change in this section of the House bill.

SECTION 23(O) (REVENUE ACT OF 1932). FUTURE EXPENSES
IN CASE OF CASUAL SALES OF REAL PROPERTY.

The present law permits an individual who makes a casual sale of real property to reduce his gain from such sale by expenditures which he has contracted to make but which can not be determined until a later year. The Treasury interprets section 22 as authorizing the application of this principle to any sale of real estate regardless of whether it is a casual sale. Under such an interpretation, a special rule is unnecessary and this subsection is, therefore, omitted as surplusage. Your committee concurs in this omission.

SECTION 23(O)2. CHARITABLE DEDUCTIONS.

This change made by your committee prohibits the deduction for contributions made to an organization a substantial part of whose activities is participation in partisan polities or in carrying on propaganda, or otherwise attempting to influence legislation.

SECTION 23(P). DIVIDENDS RECEIVED BY CORPORATIONS.

Section 23(p)2 and section 25(a)2 of existing law treat dividends from a foreign corporation in the same manner as dividends from a domestic corporation, provided such foreign corporation receives more than 50 per cent of its gross income from sources within the United States. It is believed that all dividends received from foreign corporations should be treated alike, regardless of whether such foreign corporation has income from sources within the United States. Accordingly, the House bill omits section 23(p)2 and section 25(a)2. The effect of this omission is to deny a deduction to a domestic corporation for all dividends received from foreign corporations, and to deny to any individual receiving such dividends the exemption from normal tax. Your committee made no change in this section of the House bill.

SECTION 23(Q). PENSION TRUSTS.

This subsection makes it plain that any deduction allowable under the corresponding subsection of the 1932 Act and apportioned under that Act to any year or years beginning after December 31, 1933, may be allowed for a taxable year covered by the proposed bill. Your committee makes no change in this subsection of the House bill.

SECTION 23 (R), (S), AND (T) (REVENUE ACT OF 1932). CLERICAL.

These subsections are omitted from the House bill because of the new policy adopted in the treatment of capital gains and losses, as already described in the first part of this report. Your committee concurs in these omissions.

SECTION 24(A)5. DISALLOWANCE OF DEDUCTIONS ATTRIBUTABLE TO TAX-EXEMPT INCOME.

The House bill disallows amounts otherwise allowable as deductions which are allocable to one or more classes of tax-exempt income even though the income fails to materialize or is received in an amount less than the expenditures made or incurred. For instance, under the present law, salaries received by State employees, income from leases of State school lands, and the interest on State and some classes of Federal securities are exempt from the income tax. It is contended that under the existing law all expenses incurred in the production of such income are allowable as deductions. The House bill specifically disallows expenses of this character. While your committee is in general accord with the House provision, it is not believed that this disallowance should be made to apply to expenditures incurred in earning tax-exempt interest. To do so might seriously interfere with the sale of Federal and State securities, which would be unfortunate during the present emergency. Accordingly, your committee recommends that the disallowance be applied to all classes of tax-exempt income except interest. Thus, a bank or other financial institution will not be denied a deduction for expenses incurred in earning tax-exempt interest.

SECTION 24(A)6. FAMILY LOSSES.

The House bill adds to existing law a paragraph which will deny losses in the case of sales or exchanges of property between members of a family, or between a shareholder and a corporation in which such shareholder owns a majority of the voting stock. The term “family” is defined to include brothers and sisters, spouse, ancestors, and lineal descendants. Your committee makes a slight change in the House provision with respect to transfers to a closely held corporation. Instead of making the test depend upon the ownership of a majority of the voting stock of such corporation, the standard is changed so that it depends upon the ownership of 50 per cent in value of the outstanding stock. This corresponds with the change made by the House in the section of the bill dealing with personal holding companies. Its effect is to disallow a deduction for losses on sales or exchanges of property to corporations by those owning the majority in value of the stock of such corporations, even though actual control may be in a few individuals who own little stock.

Experience shows that the practice of creating losses through transactions between members of a family and close corporations has been frequently utilized for avoiding the income tax. It is believed that this provision will operate to close this loophole of tax avoidance.

SECTION 25. CREDITS OF INDIVIDUAL AGAINST NET INCOME.

The provisions of this section have been fully described under item (3) of the first part of this report in connection with the new tax-rate structure proposed. It will be noted that this particular section provides that the personal exemption and credit for dependents shall be allowed as a credit against net income for both normal and surtax purposes. An earned income allowance is also provided for. Earned income does not include any amount not included in gross income. For example, a taxpayer whose entire earned income consists of a salary which is exempt from tax is in no case entitled to an earned-income credit in excess of $3,000. The maximum credit in all cases under the House bill is limited to $8,000. Your committee increases the maximum earned income from $8,000 to $20,000. Under the House provision, the maximum tax relief which could be secured is $32; under your committee proposal, the maximum tax relief from this provision will amount to $80.

SECTION 26. CREDITS OF CORPORATIONS AGAINST NET INCOME.

The House bill omitted as surplusage the provision of existing law which allowed to corporations a credit against net income of the amount received as interest upon obligations of the United States, which is exempt from the normal tax. The reason assigned for the change was that since the surtax is not levied upon corporations, such interest is excluded from gross income under section 22(b)4 of existing law which provides for the exclusion “to the extent that it is wholly exempt to the taxpayer from the taxes imposed by this title.” Your committee is of the opinion that the credit provided for in existing law ought to be retained and extended to apply to interest upon obligations of a corporation organized under Act of Congress, which is exempt from the normal tax under the Act creating such corporation. This will provide a uniform treatment of partially tax-exempt interest in the case of both individuals and corporations. In either case, under your committee amendments, the interest will be included in gross income and taken out as a credit. Moreover, the expression “exempt to the taxpayer” in section 22(b)4 of the House bill is not entirely clear and was the cause of the ambiguity complained of in the existing law. It is difficult to think of gross income in the light of its exemption to the taxpayer. To carry out this policy of your committee, changes have also been made in sections 13, 22(b)4, 102, 201, 203(a), 204, and 261 of the House bill.

SECTION 33. CREDIT FOR OVERPAYMENTS.

The differences from existing law are merely clerical, made necessary by the change in the treatment of fiscal years described under section 1.

SECTIONS 42 AND 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The courts have held that income accrued prior to the death of a decedent on the cash basis is not income to his estate, and under the present law, unless such income is taxable to the decedent, it escapes income tax altogether. By the same reasoning, expenses accrued prior to death can not be deducted by the estate. Sections 42 and 43 of the House bill were so drawn as to require the inclusion in the income-tax return for the decedent of all items of income and deductions accrued up to the date of death regardless of the fact that the decedent may have kept his books on a cash basis. The change made in section 43 is necessary to effectuate the policy adopted in the House bill in section 42. By reason of the proposed change such items as accrued dividends and interest on partially tax-exempt securities are permitted as a credit in computing the normal tax.

SECTION 44(B). SALES ON INSTALLMENT BASIS.

Under the present law, the installment method of reporting income may be used where the initial payments do not exceed 40 per cent of the selling price. The percentage has been changed to 30 per cent, since it is believed that the 40 per cent limit results in an unreasonable postponement of tax in cases where such tax can well be paid in the year of the sale. In case of sales consummated in any taxable year prior to January 1, 1934, the per cent prescribed in the law applicable to the year of sale is retained. Your committee has made no change in the House bill in respect to this section.

SECTION 44(D). GAIN OR LOSS UPON DISPOSITION OF INSTALLMENT OBLIGATIONS.

This amendment to the House bill makes it clear that where the profit on the sale or exchange of property is returned on the installment basis by spreading the profit over the period during which the installment obligations are satisfied or disposed of, such profit shall be taken into account under the brackets set forth in section 117 of the bill according to the period for which the original property sold was held rather than according to the period for which the installment obligations were held. For example, A sells property held for six years for twice its cost and returns the income on the installment basis. A year and a half later A sells a $100 note received on the sale for $80. Applying the amendment, the $30 profit recognized comes under the 40 per cent bracket of section 117 and not under the 80 per cent bracket.

SECTION 45. ALLOCATION OF INCOME.

Under section 45 of the existing law, the Commissioner has authority to allocate items of income or deductions between trades or businesses which are owned or controlled by the same interests, when such allocation is necessary to prevent evasion of taxes. While it is believed that the language of the present law is broad enough to include “organizations,” this word is added to remove any doubt as to the application of this section to all kinds of business activity. Your committee makes no change in this section of the House bill.

SECTION 47(D). CLERICAL.

This section has been made to conform to the change in the method of treating capital gains and losses, as already described. The House bill contained this change.

SECTION 48(A). CLERICAL.

This section conforms with the policy of treatment of fiscal-year returns as provided in section 1. The House bill contained this change.

SECTION 48(D). CLERICAL.

This amendment is declaratory of existing law.

SECTION 52. CORPORATE RETURNS.

The present law requires that corporate returns be sworn to by the president, vice president, or other principal officer and by the treasurer or assistant treasurer. Your committee has amended this provision so as to permit the chief accounting officer to sign in place of the treasurer or assistant treasurer. Since the chief accounting officer has supervision over the financial records there appears to be no reason why he should not be given authority to swear to the correctness of the corporate return.

SECTION 56(H). INCOME-TAX RECEIPTS.

This section is stated differently from the corresponding provision of existing law for the purpose of uniformity and simplicity and now corresponds to the more concise language used in connection with the provisions of the gift and estate tax provisions governing the issuance of receipts. The House bill contained this change.

SECTION 63 AND 64.

These sections contain clerical changes in respect to existing law. The House bill contained this change.

SECTION 65 (REVENUE ACT OF 1932). CLERICAL.

This section is omitted from the bill, as the effective date of the income-tax title of the bill is taken care of in section 1.

SECTION 101 (REVENUE ACT OF 1932). CLERICAL.

This section has been omitted on account of the change in policy in the treatment of capital gains and losses, which has already been described under item (3) of the first part of this report. The new provision covering this subject will be found in section 117 of the bill.

SECTION 101(6).

The change in this section is recommended by your committee in accordance with the change already mentioned in connection with section 23(o).

SECTION 102 (REVENUE ACT OF 1932). CLERICAL.

This section is omitted from the bill. It provides that in the case of a sale of mines and oil or gas wells where the principal value of property has been demonstrated by prospecting or discovery done by the taxpayer, the surtax on the profit from such sale shall not exceed 16 per cent of the selling price. This provision apparently was inserted in the law to encourage the development of new mines and oil wells. In the present state of overproduction there is no need to continue this provision, which taxes large profits from the sales of certain kinds of property on a different basis from that applicable to property generally. This change was made by the House bill.

SECTION 101(15). CLERICAL.

This section of the House bill conforms with the policy explained under section 22(b)4. It exempts from the income tax those corporations which are made exempt from such tax as instrumentalities of the United States under the Acts of Congress creating them. Your committee made no change in this section of the House bill.

SECTION 102. SURTAX ON CORPORATIONS (OTHER THAN PERSONAL HOLDING COMPANIES) IMPROPERLY ACCUMULATING SURPLUS.

This section takes the place of section 104 of existing law and is designed to take care of those corporations which do not fall within the category of personal holding companies, but which, nevertheless, have accumulated surplus to prevent the imposition of surtaxes on their stockholders. The House bill changes the existing law in two respects, namely, the rate of the added tax is changed from 50 to 25 per cent, and dividends paid during the taxable year are permitted to be deducted from the net income to which the 25 per cent rate applies. Your committee makes the following changes in the House bill:

(1) Instead of providing for an increased tax of 25 per cent, a graduated surtax is imposed at the following rates:

(*a*) 25 per cent of the amount of the adjusted net income not in excess of $100,000 plus (*b*) 35 per centum of the amount of the adjusted net income in excess of $100,000.

A surtax is imposed to remove any doubt of the right of Congress to include in the income subject to the tax the interest from partially tax-exempt securities. The Acts authorizing the issue of such securities exempt the interest therefrom from all income taxation, except surtaxes and excess and war profits taxes. This section, as rewritten by your committee, makes it clear that this tax is a surtax at graduated rates, which can be imposed upon such interest.

(2) The term “adjusted net income” is used instead of the term “net income” provided for in the House bill. This change is made for the reason that the income upon which the tax is imposed by this section is different from “net income” as defined in other sections of the income-tax title. Defining net income to mean one thing under one section of the income-tax title and another thing under other sections of that title leads to confusion. It should be noted that “net income” and not “adjusted net income” is to be used in computing the limitation upon the credit for foreign taxes provided for in section 131 of the bill.

(3) Since the tax under this section is now made a surtax, its computation, collection, and payment are already provided for in other sections of the income-tax title. In other words, the tax under Title I of a corporation subject to the provisions of this section consists of the ordinary corporate normal tax plus the surtax imposed by this section. The House provision providing for the computation, collection, and payment of such tax is, therefore, omitted as surplusage.

SECTION 103. TAX ON CITIZENS AND CORPORATIONS OF CERTAIN FOREIGN COUNTRIES.

This section of the House bill is designed to prevent foreign countries from levying discriminatory taxes against American citizens and corporations. To accomplish this, an additional income tax is imposed by the House bill upon citizens and corporations of a foreign country if the President finds that such foreign country is imposing discriminatory taxes against citizens or corporations of the United States. The additional tax is equal to 50 per cent of the income tax which the foreign citizen or foreign corporation is required to pay, to be collected in the same manner as the ordinary tax. If the President finds that the foreign country has removed the discriminatory taxes against American citizens and corporations, he shall so proclaim and the additional tax will not apply to any taxable year beginning after the date of such proclamation. Your committee makes two major changes in this section, which, it is believed, will greatly add to its effectiveness.

In the first place, the section is made to apply if the foreign country levies extraterritorial taxes, as well as discriminatory taxes. Thus, a tax on income not properly within the jurisdiction of the foreign country imposing such tax will come within this classification. In the second place, the rate of tax is increased from 50 per cent to 100 per cent. It appears that a 50 per cent increase will be only an idle threat in some cases, due to the high taxes imposed by some foreign countries upon American citizens. However, to prevent actual confiscation of the foreigner's income, it is provided that this section shall not operate to increase the rate of tax imposed by other sections of the bill to an amount in excess of 80 per cent of the taxpayer's net income. Since the effect of the section, as rewritten by your committee, is merely to increase the ordinary rate of tax imposed upon citizens and corporations of foreign countries by other sections of the bill, the computation, collection, and payment of the tax are already provided for. Your committee, therefore, omits as surplusage the provisions of the House bill relating to the computation, collection, and payment of such tax.

SECTION 105 (REVENUE ACT OF 1932). CLERICAL.

This section is omitted from the bill. This is necessary on account of the change in treatment of fiscal-year returns as explained in section 1. Your committee concurs in the action taken by the House in this connection.

SECTION 111(A). COMPUTATION OF GAIN OR LOSS.

The words omitted from existing law are surplusage, since there are no exceptions to the rule stated. The new matter is made necessary because section 113 of the bill in some instances provides one basis for gain and a different basis for loss. Under existing law the basis for gain and the basis for loss are always identical. This omission was provided for in the House bill.

SECTION 112(C)2. CLERICAL.

This section differs from existing law in view of the change made in section 115(b).

SECTION 112(G) (REVENUE ACT OF 1932). DISTRIBUTION OF STOCK ON REORGANIZATION.

This section of the Revenue Act of 1932 is omitted from the House bill. Under this section, if Corporation A organizes a subsidiary, Corporation B, to which it transfers part of its assets in exchange for all of the stock of Corporation B, and distributes the stock of Corporation B as a dividend to its stockholders without the surrender by the stockholders of any of their stock, then such a dividend is not subject to income tax. By omitting this section, the stockholders must pay a tax upon receipt of such dividends. This change is further explained in the first part of the report under the subject of Exchanges and Reorganizations. Your committee concurs in this omission.

SECTION 112(H) (REVENUE ACT OF 1932). EFFECT ON FUTURE DISTRIBUTIONS.

This section has been incorporated in section 115(h) of the bill, with such changes as are necessary to bring the language in accord with that section. It provides that a distribution by a corporation in connection with a reorganization of stock or securities in another corporation, a party to the reorganization, shall not be considered a distribution of earnings or profits for the purpose of determining the taxability of subsequent distributions by the corporation. While such distributions are no longer tax-free, because of the omission from the bill of section 112(g) of existing law, it is necessary to continue this provision with respect to distributions made before January 1, 1934, the effective date of the new bill. Your committee concurs in this omission.

SECTION 112(G). DEFINITION OF REORGANIZATION.

This section of the bill is explained under the heading of “Exchanges and Reorganizations,” contained in the first part of this report.

SECTION 112(I). CLERICAL.

These are clerical changes made necessary by the action taken by the House in omitting section 112(g) of existing law.

SECTION 113(A)2. BASIS FOR PROPERTY ACQUIRED BY GIFT.

Under section 113(a)2 of the present law, if a taxpayer acquires property by gift he is required to use as his basis the basis the property had in the hands of the donor. This section has been utilized to transfer losses from one person who has little income to another person with a large income. For instance, a taxpayer has property which cost him $100,000, but which is now practically worthless. If he sells the property himself, the loss on the sale may not do him any good, due to the fact that he has no income against which to offset it. He transfers such property by gift to a relative or close friend with a large income, and such relative or close friend makes the sale and reduces his income by a $100,000 loss. To prevent such avoidance, this section of the House bill requires the donee to use, for the purpose of determining loss, the donor's basis or the market value of the property at the time of the gift, whichever is lower. Your committee made no change in this section of the House bill.

SECTION 113(A)4. BASIS FOR PROPERTY ACQUIRED UNDER POWER OF APPOINTMENT.

The last sentence of section 113(a)4 of the Revenue Act of 1932 has been omitted from the House bill. The sentence prescribes the basis for gain or loss in the case of property passing under a general power of appointment exercised without consideration by will or deed in contemplation of death. Property transferred in this manner is included in the decedent's gross estate for estate-tax purposes.

If such property passes under a general power of appointment exercised by will, its basis for gain or loss should be the same as that prescribed in the case of other property passing by bequest, devise, or inheritance. On the other hand, if the property passes under a power of appointment executed by deed without consideration and in contemplation of death, it represents a gift and should be subject to the same basis rule which applies to other gifts in contemplation of death. This result is accomplished by omitting the last sentence of section 113(a)4 of existing law and by providing in section 113(a)5 that property passing under a general power of appointment exercised by will shall be deemed to be property passing from the individual exercising such power by bequest or devise. Your committee made no change in this section of the House bill.

SECTION 113(A)5. BASIS FOR PROPERTY ACQUIRED BY DEATH.

Under section 113(a)5 of the Revenue Act of 1932, the basis for determining gain or loss, for income-tax purposes, on the sale or other disposition of property transmitted at death, is, in the following cases, the fair market value thereof at the time of the death of the decedent:

(1) Where personal property was acquired by specific bequest;

(2) Where real property was acquired by general or specific devise, or by intestacy;

(3) Where the property, real or personal, was acquired by the decedent's estate from the deceased.

In all other cases, if the property was acquired by will or intestacy, the basis is the fair market value of the property at the time of distribution to the taxpayer.

Included within the phrase “all other cases” is personal property acquired by general or residuary bequest. Thus, where a trustee acquires personal property by general bequest, the basis of the property on a sale by him, is the value at the time of distribution to him. The basis to the executor, in all cases, is the value of the property at the date of the decedent's death.

Oftentimes, the executor and trustee under a will are one and the same person. Thus, in the case of a general bequest of personal property, he is in a position to make use of one basis of valuation or the other according to which will most benefit the estate. The trustee, of course, may use a later basis than the executor, and where it is desired to sell personal property subject to a trust during the period of administration, the executor-trustee may determine whether it would be most advantageous to sell as executor or as trustee. Where the personal property has increased in value in the hands of the executor, under a general bequest, the property may be distributed to the trustee, who may use the higher basis in computing gain or loss on the sale, thereby diminishing the taxable increment and greatly reducing or entirely avoiding the income tax.

Section 113(a)5 of the Revenue Act of 1932 is a reenactment of a similar provision contained in the 1928 Act. The change in the 1928 Act was made because there was some doubt as to the meaning of the term "date of acquisition," which was the term used under the Revenue Act of 1926. Since the 1928 Act was passed, the Supreme Court has defined "the date of acquisition" to mean the date of death in the case of all property passing by bequest, devise, and inheritance, whether real or personal. (*Brewster v. Gage,* 280 U. S., 327.) Section 113(a)5 of the House bill conforms to the language contained in the Revenue Act of 1926, so that a uniform basis rule may be required in the case of property passing at death, whether real or personal. The only change made by your committee to this paragraph of the House bill is to make it clear that if the property of the decedent is sold by the executor or other representative of the estate of the decedent, the basis for computing gain or loss from such sale is the fair market value at the date of death, which is the same basis adopted under the House bill when the property is sold by the beneficiary. The section also includes a provision relating to general powers of appointment exercised by will, which was explained in connection with section 113(a)4.

SECTION 113(A)9. CLERICAL.

Section 113(a)9 of existing law is omitted, as unnecessary, since section 112(g) of the present law has been eliminated.

SECTION 113(A)12. CLERICAL.

Subsection (a)(12) is a new provision inserted to make it clear that taxpayers who have acquired property in any taxable year beginning prior to January 1, 1934, under tax-free exchanges, where the basis is provided for in section 113(a) (6), (7), and (9) of the present law, must retain such basis.

SECTION 113(A)13. BASIS FOR PARTNERSHIP PROPERTY.

Subsection (a)(13) (basis for partnership property) is a new provision which is declaratory of existing law. Its purpose is explained under the heading of "Partnerships" in the first part of this report. The House bill also made certain clarifying amendments to paragraphs (6), (9), (12), and (13) of section 113(a) of existing law. The amendments make it clear that the property referred to in each of the paragraphs does not include property acquired prior to March 1, 1913. The basis of property acquired prior to March 1, 1913, is sufficiently covered by the first clause of section 113(a) of the bill and paragraph (14) of that section, and it is unnecessary to include such property in the exceptions made to that clause by the paragraphs of section 113 to which these amendments relate. Your committee makes no change in these paragraphs of the House bill.

SECTION 113(A)14. BASIS FOR PROPERTY ACQUIRED PRIOR TO MARCH 1, 1913.

Under section 113(a)14 of existing law, the basis for determining gain or loss in the case of property acquired prior to March 1, 1913, is its cost or fair market value as of that date, whichever is greater. This rule when applied to losses in some instances may grant the taxpayer a loss when no loss has been actually sustained. For instance, suppose a taxpayer bought property for $20,000 prior to March 1, 1913, which was worth $75,000 on that date. If he sells such property in 1933 for $60,000, he may attempt to take a loss of $15,000, although he has in fact sold it for more than he paid for it. Under the House bill no loss is allowed in any case where the selling price exceeds the taxpayer's investment in the property. The House bill also made a clarifying change in this paragraph. The change makes it clear that when comparing the cost or other basis of property acquired before March 1, 1913, with its March 1, 1913, value, the cost or other basis of the property should be adjusted up to March 1, 1913, for the purpose of making the comparison rather than to some subsequent date when the property is disposed of. The effect is to write into the statute the very logical interpretation which has been given to the existing law. Your committee made no change in this paragraph of the House bill.

SECTION 114. BASIS FOR DEPRECIATION AND DEPLETION.

Subsections (a) and (b)(1) prescribe as the general basis for computing depreciation and depletion allowances the basis for determining gain upon the sale or other disposition of property. Since in some cases the basis for determining gain differs from the basis for determining loss, it is necessary to specify definitely which of these bases is to be used for depreciation and depletion purposes.

Subsection (b) (2) and (3) contain clarifying changes to make it plain that depletion is actually allowed under section 23 instead of section 114. Your committee made no change in these paragraphs of the House bill.

SECTION 114(B)4. PERCENTAGE DEPLETION FOR COAL, METAL MINES, AND SULPHUR.

Under the Revenue Act of 1932, percentage depletion was first allowed in the case of coal, metal, and sulphur mines. That Act required the taxpayer to make in his 1933 return an election, binding for 1934 and subsequent years, as to whether the depletion deduction in such cases was to be computed upon a percentage basis. In order to avoid administrative complexities the House bill permitted the taxpayer a new election in making his first return under the proposed bill. The committee approves the House bill, but has inserted an amendment to the subsection so as to make the election made for 1934 binding not only upon the taxpayer, but upon any other person who subsequently acquires the property if the basis of the property (for determining gain) in his hands is under section 113 determined by reference to the basis in the hands of the person exercising the option.

SECTION 115(B). SUBPLUS ACCUMULATED PRIOR TO MARCH 1, 1913.

Under the present law, if a corporation pays a dividend out of earnings or profits accumulated before March 1, 1913, or out of increase in value of property accrued before March 1, 1913, the dividend in either case is not taxable to the shareholder, but the amount of the dividend reduces the basis of the stock in his hands. Under the House bill the dividend would be subject to tax as in the case of any other dividend, and the basis of the stock would not be reduced. The provisions of the present law have been in force, except for certain amendments, since the 1916 Act, and your committee believes that they should continue in force. Consequently, they have been restored without change. Subsections (a), (d), and (g) of this section have been amended to conform to this policy.

SECTION 115(C). DISTRIBUTION IN LIQUIDATION.

Under existing law, a distribution in liquidation of a corporation is treated in the same manner as a sale of stock. This rule has serious objections, as it permits wealthy stockholders to escape surtax upon corporate earnings or profits distributed in the form of liquidating dividends. For instance, a corporation may have a surplus of $1,000,000. If the surplus is distributed as an ordinary dividend it is subject to the surtax rates in the hands of the shareholders. If it is distributed as a liquidating dividend it is subject only to the flat capital gain rate of 12 ½ per cent in case the shareholder has held his stock for more than two years.

Your committee recognizes that liquidating dividends do contain some of the elements of a sale in that the shareholder is relinquishing in whole or in part his investment in the corporation. On the other hand, they also contain some of the elements of an ordinary dividend in so far as they represent a distribution of corporate earnings or profits.

The House bill retains the principle of the present law of taxing to the shareholder only the amount by which the liquidating dividend exceeds the basis of the stock with respect to which the dividend is paid. However, to prevent avoidance of surtax through liquidating dividends, the gain to the shareholder is made subject to both normal and surtax. This is accomplished by taxing the gain in the same manner as if it were a gain from a sale or exchange of a capital asset held for not more than one year, even though the shareholder may have actually held the stock upon which the dividend is paid for a longer period. But if a loss results from a liquidation of stock, the loss is treated as a loss resulting from a sale or exchange of a capital asset and is therefore subject to the provisions of section 117 of the bill. Accordingly, in arriving at his deductible loss, the shareholder must first ascertain what percentage of the loss may be taken into account under section 117(a) (which depends upon the length of time he held the stock surrendered upon liquidation), and then take as a deduction from gross income only that part of the loss taken into account which, together with his other capital losses, does not exceed his gains from sales or exchanges of capital assets. The following examples illustrate the differences in the method of treating liquidating dividends under the 1932 Act and under the bill:

Distribution in liquidation--Stock held three years.

Case 1:	
Cost of stock to shareholder...	$10,000
Amount distributed to shareholder in complete liquidation.............	15,000
Gain to taxpayer...	5,000
Taxable at capital gain rate of 12½ per cent (under 1932 law).........	5,000
Taxable at normal and surtax rates (under the bill).........................	5,000

Case 2:	***Corporation X.***	***Corporation Y.***
Cost of stock to shareholder.....................................	$10,000	$10,000
Amount distributed in liquidation............................	15,000	8,000
Gain (loss) on liquidation...	5,000	(2,000)

Shareholder pays tax of 12½ per cent of capital net gain of $3,000 (under 1932 law).

Shareholder includes $5,000 (full gain on liquidation) in gross income, and is entitled to a deductible loss of 60 per cent of $2,000 (loss on liquidation) (under the bill).

Case 3:	***Corporation A.***	***Corporation B.***
Cost of stock to shareholder.....................................	$10,000	$10,000
Amount distributed in liquidation............................	12,000	5,000
Gain or (loss) on liquidation....................................	2,000	(5,000)

Shareholder reduces tax by 12½ per cent of capital net loss of $3,000 (under 1932 Act).

Shareholder includes $2,000 (full gain on liquidation) in gross income and is entitled to a deductible loss of $2,000 (60 per cent of $5,000 loss is $3,000, or $1,000 more than gain; amount of loss only up to amount of gain is allowed) (under the bill).

Your committee made no change in this section of the House bill.

SECTION 115 (II). DISTRIBUTION OF STOCK ON REORGANIZATION.

This section has been explained in connection with the omission of section 112(g) of existing law.

SECTION 116(A). CLERICAL.

The definition of earned income is already set forth in section 25 of the bill and to avoid repetition it is omitted from this section.

SECTION 116(B). TEACHERS IN ALASKA AND HAWAII.

The Revenue Act of 1932 repealed section 5(b) of the Act of April 30, 1900, relating to salaries of Territorial employees of Hawaii. In order to prevent section 5(b) of that Act from being repealed twice, the language repealing such section is omitted from this bill. Your committee concurs in this omission.

SECTION 117. CAPITAL GAINS AND LOSSES.

The change made by your committee in the computation of capital gains and losses is fully explained in the first part of this report.

SECTION 119. INCOME FROM SOURCES WITHIN THE UNITED STATES.

Subsection (a)(1) of the present law has been construed by some courts to exempt nonresident aliens and foreign corporations from Federal income tax on any interest paid by the United States, the Territories, or the District of Columbia, on their obligations, tax refunds, or judgments. Since it is clear that Congress did not intend to exempt such income from tax, and the decisions so holding appear incorrect, the proposed change is made in order to remove any doubt as to the future. The House bill was concurred in by your committee on this point.

An amendment has been made to subsection (a)2(B) of the House bill. Under the House bill dividends from foreign corporations (50 per cent or more of the gross income of which was derived from sources within the United States) are subject both to normal tax and surtax in the hands of an individual and are fully subject to income tax in the hands of a recipient corporation, and at the same time such dividends are taxable in full by the country under the laws of which the corporation is organized. Unless such dividends are treated for credit purposes as income from sources without the United States, a citizen of the United States or a domestic corporation will be unable to take a credit against its Federal income tax for the income taxes paid to a foreign country on such dividends. This follows because of the limitation on the credit for foreign taxes contained in section 131(b) of the House bill. In order to rectify this situation and provide for a credit in such cases, your committee has amended the House bill so that dividends from such foreign corporations will be treated for purposes of section 131 as income from sources without the United States.

SECTION 131. FOREIGN TAX CREDIT.

Section 131 of the present law provides for the crediting of foreign taxes against the Federal income tax under certain limitations. The maximum benefit under the provision for the tax paid each foreign government is never greater than an amount that will relieve that portion of the income from foreign sources from the total domestic tax burden. The present credit, therefore, does not operate to relieve domestic income from tax, but does relieve the taxpayer from a double tax upon his foreign income. The House bill reduced the credit provided in the present law by limiting the credit to the proportion of the tax which one-half the net income from each foreign source bears to the total income. This in effect reduced the benefit under the present law to one-half in all cases where the foreign tax paid was equal to, or greater than, the domestic tax. The House bill also struck out the parenthetical expression "(not deductible under section 23(p))" in subsection (j) of this section. These words were omitted as surplusage for the reason that no deduction for dividends from foreign corporations is now allowed by the bill.

The committee recommends the restoration of the limitation permitted under existing law. It is believed the restriction in the House bill places an undue burden upon income from foreign sources. Under the House bill an exporter or trader is at a serious disadvantage by reason of the necessity to pay taxes to two governments on the same income, the total amount of which taxes may be greatly in excess of the taxes paid by his foreign competitor.

SECTION 132 (REVENUE ACT OF 1932). CLERICAL.

The omission of this section is necessitated by the change in the policy of treating fiscal year taxpayers as explained in connection with section 1 of the bill.

SECTION 141. CONSOLIDATED RETURNS OF CORPORATIONS.

The present law permits the filing of consolidated returns under certain conditions but imposes an additional tax of 1 per cent for this privilege. In the House bill the additional tax was increased to 2 per cent. There are numerous advantages in filing consolidated returns such as offsetting the losses of unprofitable companies, postponement of profits on intercompany transactions, etc., which in the opinion of the committee fully justify the change made in the House bill. Your committee, therefore, approves the change made in the House bill. There is added, however, a clarifying change to make it plain that the tax with the added rate is imposed by the same provisions of the bill which impose taxes upon separate corporations.

SECTION 143. WITHHOLDING OF TAX AT SOURCE.

The present law provides for withholding by a corporation or other obligor of an amount equal to 2 per cent of the amount of interest paid on bonds or other obligations which contain a tax-free covenant. The tax withheld is paid over to the Government, and the obligee on furnishing proof is credited with the amount of tax withheld. The House bill discontinued the requirement of withholding as to bonds issued after January 1, 1934. Other minor changes were made in this section to effectuate the policy adopted in the House bill in section 11.

From the Government viewpoint there seems no more reasons for withholding in the case of bond interest than in the cases of salaries, dividends, and other items. The change made in the House bill is in the interest of simplicity and is approved. On the other hand, the withholding provision should be retained as to bonds now outstanding, as the House bill provides, in order that the corporate obligors may not reap a profit at the expense of their bondholders. However, your committee recommends the date of discontinuance of such provision should be set forward to July 1, 1934, so as to avoid any confusion in the marketing of present issues.

SECTION 148(B). PROFITS DECLARED AS DIVIDENDS.

This subsection is entirely rewritten, not with any view to a change in policy, but with the intent to set forth in more definite language the present policy.

SECTION 164. DIFFERENT TAXABLE YEARS.

The present law requires a beneficiary of an estate or trust to include in his income amounts allowed as a deduction to the estate or trust under section 162(b). In order to continue this policy, it is necessary in view of the policy adopted in section 1 to add additional language to provide for cases where the estate or trust has a taxable year beginning in 1933 and ending in 1934.

SECTION 168 (REVENUE ACT OF 1932). CAPITAL NET GAINS AND LOSSES.

This section is omitted from the bill in view of the change of policy in taxing capital gains.

SECTION 182. TAX ON PARTNERS.

This section of the House bill represents a change in section 182 of existing law in two respects: First, because of the change in the policy of treating fiscal-year returns, a new section (section 188) is carried in the bill to provide specifically a method of taxing the distributive shares of the net income of a partnership for a fiscal year beginning in 1933 and ending within the taxable year of a partner whose taxable year begins on or after January 1, 1934.

This change is discussed under section 188 of the bill. Second, the provisions of existing law which prohibit the partners from using stock losses disallowed to the partnership in computing their individual net incomes have been omitted from the bill. This change was necessary because such provisions applied only to losses on stocks and bonds held for not more than two years. The bill, in section 117, treats all capital losses alike whether from stocks, bonds, or other property. Under the proposed method of treating capital gains and losses, a partner will not be permitted to reduce his income by any capital losses disallowed to the partnership. Your committee made no change in this section of the House bill. The subject of partnerships is further discussed in the first part of this report under the heading “(9) Partnerships.”

SECTION 183. COMPUTATION OF PARTNERSHIP INCOME.

This section represents a change in existing law so as to allow a partnership a deduction for charitable contributions up to 15 per cent of its net income. In such cases, the individual members of the partnership will not be entitled to a deduction in their individual returns for charitable contributions made by the partnership. Your committee made no change in this section of the House bill.

SECTION 184. CREDITS AGAINST NET INCOME.

The change made by this section is declaratory of existing law. Under existing law a partner is entitled to a credit against his net income for his proportionate share of dividends and partially taxed interest received by the partnership. These credits are allowed to the partners because they can not be utilized by the partnership. However, the partners should not be entitled to receive these credits if the partnership has sustained a net loss or has no net income. The change makes it clear that the individual partners are only entitled to such credits to the extent that they do not exceed the net income of the partnership. Your committee made no change in this section of the House bill.

SECTION 186 (REVENUE ACT OF 1932). CAPITAL NET GAINS AND LOSSES.

This section is omitted on account of the change in policy in taxing capital gains and losses.

SECTION 188. DIFFERENT TAXABLE YEARS OF PARTNER AND PARTNERSHIP.

Subsection (a) applies the same general rule for computing the net income of a partner whose taxable year is different from that of the partnership as the rule contained in existing law. However, it is necessary to provide a special rule for the computation of the net income of a partner whose taxable year begins after December 31, 1933, if the partnership of which he is a member has a fiscal year beginning in 1933. The net income of the partnership for the fiscal year beginning in 1933 is computed under the

Revenue Act of 1932, except that the capital gains and losses of the partnership are computed in accordance with section 117 of the bill, but without regard to the limitation on capital losses. Your committee made no change in this section of the House bill.

SECTION 201. CLERICAL.

The changes in this section are necessary to conform to action of your committee in restoring section 26 of existing law.

SECTION 203(A)1. TAX-FREE INTEREST.

The change in this section is a clarifying change made to bring the language of the section in accord with the language of section 22(b)4 and section 26.

SECTION 203(A)3. DIVIDENDS.

This paragraph contains a clarifying change made necessary to carry out the policy expressed in section 23(p) of the bill.

SECTION 203(A)8. INTEREST.

This paragraph contains a clarifying change made necessary to carry out the policy of disagreeing to the change made by the House in section 23(b).

SECTION 204. INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.

The additional language in subsection (c)(5) is added to carry out the policy adopted of limiting losses from capital assets to gains from similar transactions. The other changes to this section are made necessary as a result of the action of your committee in restoring section 26 of existing law.

SECTION 211 (REVENUE ACT OF 1932). NORMAL TAX--NONRESIDENT ALIEN INDIVIDUALS.

This section of existing law has been omitted from the bill. This is a clerical change, since section 11 of the bill provides only one rate of normal tax.

SECTION 214. ALLOWANCE OF DEDUCTIONS AND CREDITS.

The change made in this section is necessitated by the omission of section 211 of existing law from the bill.

SECTION 261. CREDIT AGAINST NET INCOME.

The change made by your committee to this section of the House bill is made necessary by the action taken in restoring section 26 of existing law.

SECTION 272. PROCEDURE IN GENERAL.

The present law allows the taxpayer in case of a deficiency a period of 60 days within which to file an appeal with the United States Board of Tax Appeals. Experience has shown this is not sufficient time in case of involved assessments, or in case of taxpayers living at a great distance from Washington. In the House bill the period for filing appeals was increased to 90 days.

Your committee recommends the adoption of this section of the House bill with a slight change so that a legal holiday in the District of Columbia will not be counted as the ninetieth day.

SECTION 274. BANKRUPTCY AND RECEIVERSHIPS.

The present law provides for immediate assessment in cases of bankruptcy or receivership regardless of the restrictions imposed by section 272(a). The result of bankruptcy or receivership is, therefore, to take the case from the jurisdiction of the United States Board of Tax Appeals in cases of deficiency. There is no specific provision, however, requiring the trustee in bankruptcy or the receiver to give notice to the Commissioner of his appointment. As a result, the statute of limitations frequently runs against the Government through inability of the Government to ascertain the status of the taxpayer. To correct this situation, a change has been made in this section by the House requiring the trustee in bankruptcy or the receiver to notify the Commissioner of the adjudication or the appointment of the receiver, and the running of the statute is suspended for a period of 30 days after the date of receipt of the notice by the Commissioner. Your committee made no change in this section of the House bill.

SECTION 275. PERIOD FOR ASSESSMENT AND COLLECTION.

The present law limits the time for assessments to two years from the date the return is filed. Experience has shown that this period is too short in a substantial number of large cases, resulting oftentimes in hastily prepared determinations, with the result that additional burdens are thrown upon taxpayers in contesting ill-advised assessments. In other cases, revenue is lost by reason of the fact that sufficient time is not allowed for disclosure of all the facts. Subsection (a), therefore, increases the period of two years to three years.

In the cases of estates of decedents or of corporations contemplating dissolution, the tax must be assessed under existing law within one year after written request therefor by the person representing the estate or corporation. Subsection (b) increases the period for assessment in such cases from 1 year to 18 months.

Under the present law the period of limitation runs from the date the return was filed. Inasmuch as many returns are filed before the date prescribed by law, it is necessary for the Government to maintain an accurate record of the dates of filing of each return in order to prevent the loss of revenue. The change in subsection (c) eliminates a substantial portion of this burden by providing that the beginning of the period for assessment in all cases shall be the last day prescribed by law for filing of the return, regardless of the fact that the return may be filed before such date.

The present law permits the Government to assess the tax without regard to the statute of limitations in case of failure to file a return or in case of a fraudulent return. The House bill continues this policy, but enlarges the scope of this provision to include cases wherein the taxpayer understates gross income on his return by an amount which is in excess of 25 per cent of the gross income stated in the return. Your committee is in general accord with the policy expressed in this section of the House bill. However, it is believed that in the case of a taxpayer who makes an honest mistake, it would be unfair to keep the statute open indefinitely. For instance, a case might arise where a taxpayer failed to report a dividend because he was erroneously advised by the officers of the corporation that it was paid out of capital or he might report as income for one year an item of income which properly belonged in another year. Accordingly, your committee has provided for a 5-year statute in such cases. This amendment also necessitates a change in section 276(a) of the bill.

SECTION 276(A). FALSE RETURN OR NO RETURN.

This section is explained in connection with the change in section 275.

SECTION 322. REFUNDS AND CREDITS.

The present law provides that no refund shall be made after two years from the time the tax was paid, unless claim therefor is filed within such period. Inasmuch as section 275 is changed so as to permit assessments for a period of three years from the date the return is filed, section 322(b)1 is changed so as to permit refunds to be made where claims are filed within three years from the date the return is filed. However, the present law permits a longer period for refunds than for assessments in cases where the taxpayer has paid his tax by installments. To correct this inequality, the period for refunds is fixed as two years from the time the tax was paid or three years from the date the return was filed.

A clerical change is made in subsection (b)(2) to carry out the policy in subsection (b)(1).

Under the present law, if the Board finds there is an overpayment instead of a deficiency, the case is returned to the Commissioner for determination as to whether the overpayment is barred by limitation. If the Commissioner finds that the overpayment is barred by limitation and the taxpayer questions the correctness of such finding, it is necessary for the taxpayer to resort to the courts. The provision of subsection (d) enlarges the Board's jurisdiction by giving it authority to decide the limitation question and thus to terminate the litigation in one proceeding. Your committee made no change in this section of the House bill.

TITLE IA. ADDITIONAL INCOME TAXES.

SECTION 351. SURTAX ON PERSONAL HOLDING COMPANIES.

This section has been fully explained in the first part of this report.

TITLE II. AMENDMENTS TO ESTATE TAX.

SECTION 401. REVOCABLE TRUSTS.

This section amends section 302(d) of the Revenue Act of 1926 relating to the inclusion in the gross estate of a decedent of property transferred by him but as to which he retains the right to alter, amend, or revoke. In such cases the decedent is for practical purposes the owner of the property which under existing law is required to be included in his gross estate. For example, where A transferred property to a trustee but retained the right at any time to alter, amend, or revoke the trust, there is no question as to the includibility of the property in A's gross estate. However, if the retained right to alter, amend, or revoke could be exercised only after a precedent notice of, say, a year, or if the alteration, amendment, or revocation would become effective only after a lapse of time after A performed the act which gave rise to the alteration, amendment, or revocation, it might be contended that under existing law the property is not includible in the decedent's gross estate. While it is believed that such contention would not be sound, it is desirable to clarify the law by providing specifically that there must be included in the gross estate all the property of which the decedent at the date of his death had practical, if not technical, ownership. This section further expressly provides that, although a notice may be required as a condition precedent to exercising the right to alter, amend, or revoke, nevertheless the full value of the property at the date of the decedent's death must be included in the gross estate, less only the outstanding estate (measured by the period required to elapse between the giving of the notice and the taking effect of any alteration, amendment, or revocation) which at the decedent's death is irrevocably beyond his control.

This section also establishes, in certain cases involving material amounts, a prima facie presumption that the relinquishment of any power to alter, amend, or revoke such as has been described, if made within two years prior to the decedent's death, was in contemplation of death. The presumption is made rebuttable, since a conclusive presumption, the Supreme Court has held, would be unconstitutional. Your committee made no changes in this section of the House bill.

SECTION 402. PRIOR TAXED PROPERTY.

This section amends section 303 of the Revenue Act of 1926 so as to restrict the estate-tax deduction granted to a decedent on account of prior taxed property. The amendment makes it clear that no deduction will be allowable for prior taxed property, unless it appears not only that the property was included in the gross estate of the prior decedent from whom the property was acquired, but also that the estate of such prior decedent was not entitled to a deduction for such property in determining the value of the net estate of the prior decedent. For example, if A dies and leaves a piece of property to B, and the inclusion of that property in A's estate results in increasing the estate tax over what otherwise would have been payable, then, if D dies within five years of A, B's estate is entitled to a deduction on account of such prior taxed property. However, if upon B's death the property passes to C, who dies within five years of B, C's estate is not entitled to a deduction on account of the property acquired by C from B, because, while the value of the property was included in B's gross estate, a deduction for such property was allowable to B's estate on account of B's having received the property from A who died less than five years prior to B. Your committee made no change in this section of the House bill.

SECTION 403 AND SECTION 404. CITIZENSHIP AND RESIDENCE OF DECEDENTS.

These sections of the House bill amend section 303 and section 304 of the Revenue Act of 1926 and section 403 of the Revenue Act of 1932 in order that Federal estate taxes will be imposed in the case of United States citizens, irrespective of whether they are residents or nonresidents, and in the case of all residents, irrespective of whether they are citizens, as to all gross estate, whether it is situated within the United States or without the United States and whether, if property is situated in foreign countries, it is real property or personal property. The result is that under the House bill all residents of the United States and all United States citizens, irrespective of where they reside, will be fully subject to Federal estate taxes, while nonresidents who are not citizens of the United States will be subject to such taxes only with respect to the value of that part of their gross estate which is situated within the United States. This rule is similar to that applied in the imposition of the Federal gift tax by section 501 of the Revenue Act of 1932 and is analogous to that applying to the Federal income tax, which in the case of residents and citizens of the United States applies to all income without regard to its source, but in the case of nonresident aliens applies only to income from sources without the United States.

Your committee is of the opinion that real property located abroad should not be subject to the Federal estate tax since it is an almost universally established principle of estate taxation that real estate should be subject to death duties only in the country where situated. To tax such real estate, will make it difficult for many American citizens to live in foreign countries in the interest of American foreign trade, for they will be subject to a tax burden much greater than that imposed on foreigners in a similar situation. Accordingly, your committee has amended the House bill to make it clear that real estate located abroad shall not be subject to the Federal estate tax. The effect of this amendment with other amendments made by the House is to place nonresident American citizens in the same category as residents and thus subject them to the estate tax with respect to all of their property except real property located abroad.

SECTION 405. ESTATE TAX RATES.

This section has been fully explained in the first part of this report.

SECTION 406. NONDEDUCTIBILITY OF CERTAIN TRANSFERS.

This change is necessary to carry out the policy adopted in section 23(o) 2.

SECTION 501. PERIOD OF PETITION TO BOARD UNDER PRIOR ACTS.

This change for prior Acts is made necessary by reason of the policy adopted in section 272, and brings the Acts referred to into accord with the present bill.

SECTION 502. RECOVERY OF AMOUNTS ERRONEOUSLY REFUNDED.

This section amends section 610 of the Revenue Act of 1928 so as to give the United States five years to bring suit to recover amounts of internal-revenue taxes erroneously refunded where any part of the refund was induced by fraud or misrepresentation of a material fact. In all other cases the period is two years, which is the period provided by existing law without regard to the circumstances under which the refund was made. Your committee made no change in this section of the House bill.

SECTION 503. STATUTE OF LIMITATIONS ON SUITS FOR REFUND.

This section amends section 608 of the Revenue Act of 1928. Under existing law the Commissioner is authorized to allow refunds after the period for filing suit for refund has expired, if the taxpayer and the Commissioner agree in writing before the expiration of such period to suspend the statute until applicable cases pending in the courts have been decided. Some question has arisen as to whether such an agreement extends the period for filing suit in case the Commissioner refuses to allow the refund. The amendment makes it clear that the period for filing suit by the taxpayer is suspended in accordance with the terms of the agreement. Your committee made no change in this section of the House bill.

SECTION 504. OVERPAYMENTS FOUND BY THE BOARD OF TAX APPEALS.

This section amends sections 322(d) and 528(d) of the Revenue Act of 1932, section 322(d) of the Revenue Act of 1928, and sections 284(e) and 319(c) of the Revenue Act of 1926 to bring those Acts into accord with the present bill in so far as the bill relates to the right of the Board of Tax Appeals to determine when an overpayment found by the Board is refundable to the taxpayer. Confusion has resulted under existing law due to the fact that the Board may find an overpayment of taxes but is not authorized to determine whether the overpayment is refundable, it being incumbent upon the Commissioner to determine whether or not an overpayment determined by the Board is barred by the running of the statute of limitations on refunds. The House bill conferred jurisdiction upon the Board to determine not only that the taxpayer has made an overpayment of tax, but also whether such overpayment is refundable so that the proceeding before the Board may result in complete disposition of the case. Your committee recommends adoption of the House provision but finds it necessary to rewrite the subsection because the period for refund of income taxes is two years whereas the period for refund of gift taxes is three years.

SECTION 505. BANKRUPTCY AND RECEIVERSHIPS.

This section amends section 274(a) of the Revenue Act of 1932 and the Revenue Act of 1928 and section 282(a) of the Revenue Act of 1926 relating to the procedure to be followed in bankruptcy and receivership cases, so that the running of the statute of limitations against the Government on the making of assessments will be suspended for the period (not to exceed two years) from the date of adjudication in bankruptcy or the appointment of the receiver to a date 30 days after the date upon which notice is received by the Commissioner from the trustee or receiver of the adjudication in bankruptcy or the appointment of the receiver. This amendment will bring the 1926, 1928, and 1932 Revenue Acts into accord with the provision in the present bill relating to the same subject, and will protect the rights of the Government. Under existing law, unless the Commissioner discovers that a taxpayer has been adjudicated bankrupt or that a receiver has been appointed for a taxpayer, he is unable to protect the rights of the Government in assessing income taxes. This is due to the fact that in case of bankruptcy or receivership the running of the statute of limitations on assessment is not suspended, as in the ordinary case, by the Commissioner's sending of a deficiency letter, since the usual restrictions upon assessment are automatically suspended. In many such cases the Commissioner will have no way of knowing that such restrictions have been suspended, unless the law provides, as this section does, that the

Commissioner is to be notified of the adjudication in bankruptcy or the appointment of the receiver. Your committee made no change in this section of the House bill.

SECTION 506. RETROACTIVITY OF RULINGS.

This section amends section 1108(a) of the Revenue Act of 1926, as amended, so as to permit the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the extent, if any, to which any regulation, Treasury decision, or ruling relating to internal-revenue taxes shall be applied without retroactive effect. The amendment extends the right granted by existing law to the Treasury Department to give regulations and Treasury decisions amending prior regulations or Treasury decisions prospective effect only, by allowing the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the exact extent to which any regulation or Treasury decision, whether or not it amends a prior regulation or Treasury decision, will be applied without retroactive effect. The amendment furthermore permits internal-revenue rulings as well as regulations or Treasury decisions to be applied without retroactive effect. Regulations, Treasury decisions, and rulings which are merely interpretive of the statute, will normally have a universal application, but in some cases the application of regulations, Treasury decisions, and rulings to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury decisions, and rulings with prospective effect only. Your committee made only clerical changes in this section of the House bill.

SECTION 507. EXAMINATION OF BOOKS AND WITNESSES.

This section is a companion section to section 1104 of the Revenue Act of 1926, as amended by section 618 of the Revenue Act of 1928, and gives to the Commissioner the right to examine books, records, and other data to ascertain the liability of transferees of property. Under existing law, if the tax liability of a taxpayer is certain, the Commissioner may have no authority to examine the books of the transferors to determine who the transferees are, or to examine the records which have fallen into the hands of other persons after the liquidation of a corporation to discover who the transferees of the corporation are. This section makes it clear that the Commissioner has the power to make examinations in such cases. Your committee made no change in this section of the House bill.

SECTION 508. SALE OF PERSONAL PROPERTY UNDER DISTRAINT.

This section amends section 3192 of the Revised Statutes so that officers of the United States selling personal property which has been seized under distraint may purchase such property for the United States if the amount bid for such property by outsiders is not equal to the minimum price for which the property is offered. Under existing law the collector can bid in only an article which is subject to tax such as oleomargarine, tobacco, spirits, etc. He can not buy for the United States a Liberty bond or a Treasury note offered at a distraint sale. If no bid was made he would be compelled to readvertise and offer again for sale the security seized under distraint. If an entirely inadequate bid was made for such security the collector would be compelled to accept it. If it were in the power of the collector to establish a minimum price for personal property offered by him for sale under the process of distraint (as it is with respect to realty, R. S. 3197), and to bid in the same for the United States, it would be possible at every sale of personalty to close the whole proceeding without the expense of advertising a resale, and without the necessity of accepting a nominal and inadequate bid for the property offered for sale. This section of the present bill will completely remedy the defect referred to. Your committee made no change in this section of the House bill.

SECTION 509. DISCHARGE OF LIENS.

The House bill amends section 3186(c) of the Revised Statutes, as amended, by providing a procedure not expressly sanctioned by existing law whereby a taxpayer who desires to sell a portion of his property under a lien for Federal taxes may obtain a release of the lien on the property he desires to sell by paying over to the collector of internal revenue toward satisfaction of his tax liability an amount determined by the Commissioner to be equal to the fair market value of the part of his property to be sold. The property referred to, the fair market value of which must be determined in each case, is the taxpayer's property, which in the case of property subject to prior liens is only the taxpayer's interest or equity in the entire property. Your committee approves the principle of this House amendment but has changed the language of the amendment to make it clear (1) that, if the interest of the United States in the portion of the property to be discharged from the lien is without value, the collector may, if satisfactory to the Commissioner, release the lien without any payment being made, and (2) that it is not the value of the taxpayer's equity in the property at the time of the discharge but rather the value of the interest of the United States at such time which controls the amount of the payment to be made as a condition precedent to the discharge. For example, if a piece of property has a present value of $1,000, but liens thereon prior to the lien of the United States amount to $800, a certificate discharging the property from the Government lien may be issued by the collector upon payment to the collector of an amount not less than $200, as determined by the Commissioner.

SECTION 510. JEOPARDY ASSESSMENTS.

Section 1105 of the Revenue Act of 1932, providing for immediate collection of miscellaneous taxes, has proved so cumbersome in operation that it has been ineffective for its purpose, the prompt assertion of taxes in cases where delay would endanger collection. The section has been simplified and worded similarly to the provision for jeopardy assessment of deficiencies of income tax. Under it, when it appears that delay may result in failure to collect the tax, immediate assessment may be made by the Commissioner, and unless the taxpayer makes payment or gives bond for payment on the due date, the collector may distrain immediately. This discretionary method of enforcing immediate payment is necessary because the character of some of the businesses taxed under existing law makes it possible for taxpayers to disappear before the due date.

SECTION 511. GIFTS OF PROPERTY SUBJECT TO POWER.

This section repeals section 501(c) of the Revenue Act of 1932, since the principle expressed in that section is now a fundamental part of the law by virtue of the Supreme Court's decision in the Guggenhelm case (53 S. Ct., 369). Your committee made no change in this section of the House bill.

SECTION 512. GENERAL COUNSEL FOR THE TREASURY.

The House bill creates in the Treasury Department the office of General Counsel for the Treasury, the General Counsel to be appointed by the President with the advice and consent of the Senate. The bill further transfers to the General Counsel for the Treasury the powers, duties, and functions of the offices of General Counsel for the Bureau of Internal Revenue, Assistant General Counsel for the Bureau of Internal Revenue, Solicitor of the Treasury, and Assistant Solicitor of the Treasury, with the resulting abolition of these offices. The House bill also provides for the appointment by the Secretary of the Treasury of not to exceed six Assistant General Counsel, who will be in immediate charge of the legal activities of the various bureaus and divisions of the Treasury, such as internal revenue, customs, banking, public debt, monetary matters, etc.

The legal activities of the Treasury Department are now handled by separate, uncoordinated legal units in the various divisions, bureaus, and offices of the Department. A single responsible law officer, having the necessary power, can coordinate the activities of these distinct legal units and prevent inconsistency of action, duplication of effort, delays, and waste of public funds. Your committee believes that the proposed reorganization of the legal activities within the Treasury Department is desirable but proposes an amendment to the House bill to require that the Assistant General Counsel shall be appointed by the President with the advice and consent of the Senate. The President, when he submits a nomination of an Assistant General Counsel, will no doubt inform the Senate of the particular division or bureau, if any, whose legal activities the nominee is to supervise.

SECTION 513. ASSISTANTS IN THE TREASURY.

The various emergency laws recently adopted by Congress impose a great number of new duties and functions upon the Secretary of the Treasury. For example, the recent monetary legislation requires the Secretary to direct the operations of the stabilization fund of $2,000,000,000 over a period of at least two years, which may be extended to three years by Presidential proclamation. To take care of this situation, the House bill has provided for the appointment by the Secretary of 10 assistants for the period of the emergency at salaries of not to exceed $10,000 per year. Your committee has changed the provision of the House bill in two respects. In the first place, the number of assistants has been reduced from 10 to 5 upon the advice of the Secretary of the Treasury that that number will be sufficient to carry out this emergency program. In the second place, your committee requires the five assistants to be appointed by the President with the advice and consent of the Senate.

SECTION 514 (HOUSE BILL). PENALTIES AND AWARDS TO INFORMERS WITH RESPECT TO ILLEGALLY PRODUCED PETROLEUM.

This provision was inserted in the House bill to aid the Government in the collection of taxes on income resulting from the sale of petroleum produced in violation of any State or Federal law. Your committee omits this section from the bill. It is believed that there are already adequate provisions in the internal revenue laws relating to penalties and rewards to informers to protect the Federal Government from any violation of the Federal tax laws.

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SECTION 515. COMMISSIONER AS PARTY TO SUIT.

It has become the practice to treat the incumbent of the office of Commissioner of Internal Revenue as a party to the proceedings before the appellate courts reviewing decisions of the Board of Tax Appeals by incorporating his name in the petitions for review addressed to such courts and, as a precautionary measure, to move for a substitution of the name of the new Commissioner when a change occurs in that office while the proceedings are pending before such appellate courts. To remove any doubt as to the necessity for such procedure, your committee has provided that petitions filed with the Board shall be entitled “In re” followed by the name of the petitioner, and that no substitution of the name of a new Commissioner shall be required in proceedings before any appellate court reviewing the action of the Board of Tax Appeals.

SECTION 516. NONDEDUCTIBILITY OF CERTAIN GIFTS.

This change is necessary to carry out the policy adopted in section 23(o) 2.

SECTION 601. SOFT DRINKS.

The House bill repealed the tax on unfermented fruit juices. Your committee proposes an amendment repealing all the taxes on soft drinks, etc., under section 615 of the Revenue Act of 1932.

SECTION 602. COCONUT OIL, ETC.

The House bill imposes a tax of 5 cents a pound on the first domestic processing of coconut oil, sesame oil, and mixtures brought into the United States in chief value of either or both such oils. The committee amendment reduces the rate to 3 cents a pound and extends the tax to palm oil, palm-kernel oil, sunflower oil, imported whale oil, imported fish oil, imported marine-animal oil, combinations of the oils enumerated in the section, and mixtures containing substantial quantities of any one or more of such oils. The use of palm oil in the manufacture of tin plate is exempted from the tax.

SECTION 603. LUBRICATING OIL AND GASOLINE.

This section amends the provisions of the Revenue Act of 1932 with respect to lubricating oils and gasoline. See the discussion in the first part of this report under the heading, “Gasoline and Lubricating Oil (Administrative changes).”

SECTION 604. PRODUCERS' TAX ON CRUDE PETROLEUM.

The House bill imposed a tax on the production of crude petroleum at the rate of one-tenth of 1 cent a barrel, payable by stamp. The section has been rewritten to provide for imposition of the tax on sale by the producer, the tax to be withheld or collected by the purchaser and paid over by him to the United States. In cases where the producer himself removes the petroleum from the place of production or disposes of it otherwise than by sale, the producer is required to return and pay the tax. This system is believed to be more workable than the stamp tax.

The provision for transferring the burden of the tax in the case of existing contracts has been eliminated as unnecessary because of the low rate of the tax.

An exemption is inserted in favor of crude petroleum produced from any well which is not capable of producing more than five barrels per day.

The effective date is made the thirtieth day after the date of the enactment of this Act.

SECTION 605. TAX ON REFINING OF CRUDE PETROLEUM.

This section imposes a tax of one-tenth of 1 cent a barrel on the first refining or processing of crude petroleum and a like tax on gasoline produced or recovered from natural gas. For the reasons given above (section 604), the provision with respect to existing contracts has been eliminated. The effective date has been postponed to the thirtieth day after the date of the enactment of the Act.

SECTION 606 (REVENUE ACT OF 1032). CHECK TAX.

The House bill advanced the date of expiration of the check tax under section 751 of the Revenue Act of 1932, from July 1 to January 1, 1935. This provision has been stricken from the bill.

SECTION 606. ENFORCEMENT OF LIABILITY FOR TAXES COLLECTED.

Existing law provides with respect to a number of taxes that the amount of the tax shall be collected or withheld from the person primarily liable by another person, who is required to return and pay to the Government the amount of the taxes so collected or withheld by him. This is true, for example, in the case of the taxes on admissions, checks, and telephone and telegraph services. Under existing law the liability of the person collecting and withholding the taxes to pay over the amount is merely a debt, and he can not be treated as a trustee or proceeded against by distraint. Section 606 of the bill as reported impresses the amount of taxes withheld or collected with a trust and makes applicable for the enforcement of the Government's claim the administrative provisions for assessment and collection of taxes.

SECTION 607. TAX ON FURS.

Section 607 of the bill as reported exempts articles sold for less than $20 from the tax under section 604 of the Revenue Act of 1932 on articles made of fur on the hide or pelt, or of which such fur is the component element of chief value.

SECTION 608. CLOCKS AND CLOCK PARTS.

Section 608 of the bill as reported eliminates clocks and clock parts from the scope of the tax under section 605 of the Revenue Act of 1932.

SECTION 609. CIGARETTES.

Under existing law cigarettes are subject to a tax of $3 per thousand, except that cigarettes weighing more than three pounds per thousand are taxed $7.20 per thousand. There have recently been placed on the market cigarettes which are 11 inches long and which are designed to be cut into four ordinary cigarettes, and on which tax has been paid at the rate of $7.20 per thousand. The Treasury has stated that it proposed to hold each of these long cigarettes taxable as four cigarettes, but your committee has deemed it advisable to insert a provision in the bill which will eliminate the possibility of the success of any such device. The provision inserted provides in effect that large cigarettes of more than the ordinary length for this class shall be taxed as if each 2¾ inches (or fraction thereof) of the length of each long cigarette were a separate cigarette.

SECTION 610. TAX ON MATCHES.

Section 612 of the Revenue Act of 1932 imposes a tax of 2 cents a thousand on matches (except paper matches in books). Importers are avoiding the duty under the Tariff Act of 20 cents per gross boxes by coloring the sticks, which subject them to the rate of 40 per cent ad valorem provided for matches having a stained, dyed, or colored stick or stem. At present values the 40 per cent rate may amount to only 5 or 6 cents per gross boxes. To offset this advantage to the colored matches, the tax on the sale of fancy wooden matches and wooden matches with a stained, dyed, or colored stick or stem is increased to 5 cents a thousand matches.

SECTION 611. STAMP TAX ON SALES OF PRODUCE FOR FUTURE DELIVERY.

The present law imposes upon each sale, agreement of sale, or agreement to sell any products or merchandise at, or under the rules of usages of, any exchange or board of trade, or similar place for future delivery a tax of 5 cents for each $100 in value. Hearings before the committee indicate this tax seriously interferes with the normal operation of produce exchanges. It is claimed the tax tends to materially restrict the volume of trading upon exchanges with the result that prices of farm products are depressed. Your committee, therefore, recommends reduction of the tax to 1 cent for each $100 value.

SECTION 701. CAPITAL-STOCK TAX.

This section is fully explained in the first part of this report.

SECTION 702. EXCESS-PROFITS TAX.

This section is fully explained in the first part of this report.

SECTION 703. CAPITAL-STOCK TAX AND EXCESS-PROFITS TAX IMPOSED BY NATIONAL INDUSTRIAL RECOVERY ACT.

This section is fully explained in the first part of this report.

Footnotes

[1] Estimated at 1 cent per gallon; i. e., exclusive of ½ cent included under the National Industrial Recovery Act taxes.

[2] Receipts for the temporary revenue provisions of the National Industrial Recovery Act are estimated for the periods prior to their termination following the proclamation on December 5, 1933, of repeal of the eighteenth amendment.

[3] Includes receipts from duties levied by section 601 of Revenue Act of 1932 (47 Stat., 261).

[4] The total amounts owing to the United States on account of obligations of foreign governments are $328,000,000 and $335,000,000 for the fiscal years 1934 and 1935, respectively. To the extent that receipts from foreign governments exceed amounts included in the estimates, there will be a corresponding increase in total receipts.

[1] Earned income means wages, salaries, professional fees, or other amounts received for personal services actually rendered.

[2] Dividends from stock of domestic corporations. Same treatment is accorded interest from partially tax-exempt Government bonds.

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